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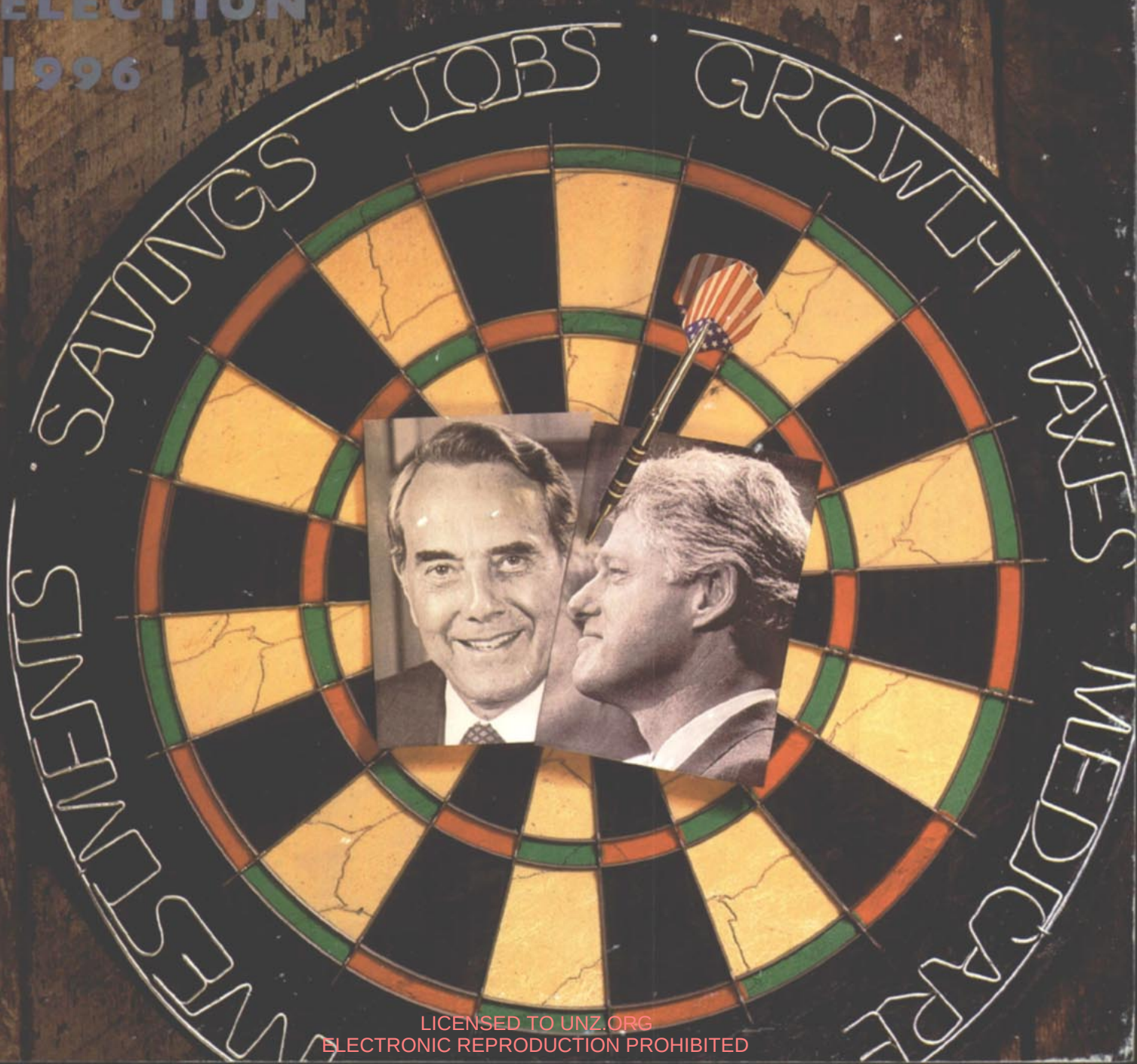
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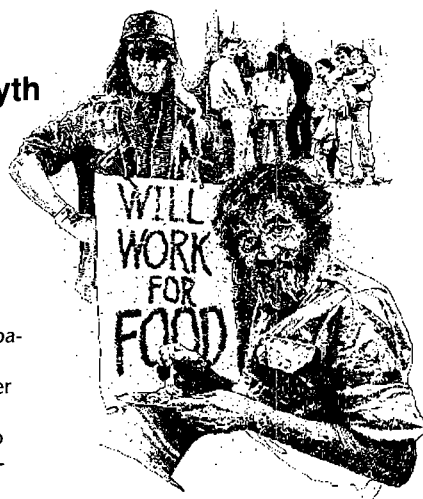
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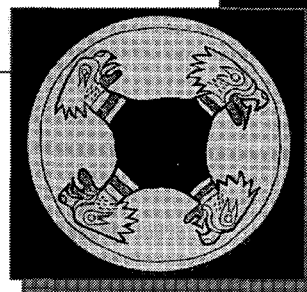
Explore the Past

The Cambridge History of the Native Peoples of the Americas

Volume I: North America

Bruce G. Trigger and Wilcomb E. Washburn, Editors

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Contributors: Peter Nabokov, Wilcomb E. Washburn, Bruce G. Trigger, Dean R. Snow, Linda S. Cordell, Bruce D. Smith, William R. Swagerty, Neal Salisbury, Michael D. Green, Loretta Fowler, Howard R. Lamar, Sam Truett, Robin A. Fisher, Frederick E. Hoxie, Arthur J. Ray, David Damas

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THE Brookings REVIEW

FALL 1996 VOL. 14 NO. 4

4 ELECTION 1996: THE CHOICES AHEAD

Introduction by Robert D. Reischauer

6 PROMISES, PROMISES

The elusive search for faster economic growth

Charles L. Schultze

10 THE BUDGET MEETS THE BOOMERS

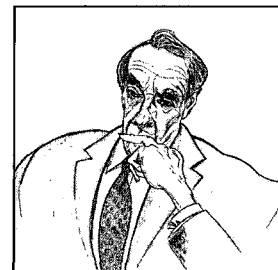
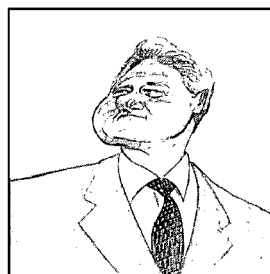
America's most famous generation approaches another milestone

Henry J. Aaron and Barry P. Bosworth

14 PROBLEMS OF PREDOMINANCE

Implications of the U.S. military advantage

John D. Steinbruner



18 NEW MOTHERS, NOT MARRIED

Technology shock, the demise of shotgun marriage, and the increase in out-of-wedlock births

George A. Akerlof and Janet L. Yellen

22 UNCLE SAM IN THE HOUSING MARKET

The Section 8 rental subsidy disaster

James R. Barth and Robert E. Litan

26 FORECASTING THE PRESIDENTIAL ELECTION

What can we learn from the models?

James E. Campbell and Thomas E. Mann

32 THE ALIENATED AMERICAN VOTER

Are the news media to blame?

Richard Harwood

36 THE DISAPPEARING POLITICAL CENTER

Congress and the incredible shrinking middle

Sarah A. Binder

40 TOO CLOSE TO CALL

A roundtable discussion of the 1996 congressional elections

Letters 3

A Considered Opinion

Can Government Nurture Civic Life?

E.J. Dionne, Jr. 3

World Watch

The Gulf War Party's Over

Shibley Telhami 45

Economy Watch

Low Inflation or No Inflation?

*George A. Akerlof, William T. Dickens,
and George L. Perry* 46

Politics Watch

America's Other ValuJets

Donald F. Kettl 47

COVER ILLUSTRATION
BY JERRY PAVEY

School Choice: Where's the Evidence?

■ Joseph Viteritti ("Stacking the Deck for the Poor: The New Politics of School Choice," summer issue) and others have recently been telling us that their chief motivation in pushing private school vouchers is helping poor children and improving public schools. That's laudable. But I would be more convinced if their claim didn't coincide with recent surveys showing that this is the only argument that makes a dent in the public's opposition to vouchers. I'd be even more receptive if the evidence backed up their position. The fact is that even if all children were in private schools tomorrow, we'd still have an educational crisis on our hands.

Contrary to Viteritti's assertion, Coleman and the other researchers who have looked at public and private school achievement found no differences once you take family background or course-taking into account. Viteritti lauds Chubb and Moe's work as a "landmark," but fails to tell us their analysis did not support private school superiority. He cites Bryk, who demolished Chubb and Moe's "landmark," for evidence that Catholic schools have been effective at educating inner-city minorities, but neglects to mention that Bryk says that competition has nothing to do with effective Catholic schools. He says that inner-city parochial schools have the same low-income "student profiles" as urban public schools, but they don't. He hails Milwaukee's low-income voucher experiment, but ignores the four-year independent evaluation showing that voucher students achieved no better than their counterparts in the city's public schools. And he never bothers with the inconvenient fact that private schools get to choose their customers and can easily expel their mistakes.

This Orwellian four-legs-good, two-legs-bad argument is getting us nowhere in helping poor children or improving schools. Successful private schools are not that way because they're "private" or "Catholic" any more than being "public" explains successful public schools. What good schools have in common is discipline and rigorous standards in the core academic subjects. These may not be exciting, but, unlike vouchers, they work and are widely supported.

Now and for the foreseeable future, the overwhelming majority of poor children—in fact, all children—will be in public schools. Their interests would be more directly and effectively served if, instead of crafting schemes to move them into private schools that have few seats and little demonstrable inclination to take them, we'd put our weight behind policies to get higher standards of conduct and achievement in all our public schools.

Albert Shanker, American Federation of Teachers

School Choice: Meaningless without Good Schools

■ Perhaps it is the fate of schools in deeply divided societies that class and race politics should determine the distribution of educational resources and opportunities; in the United States there is compelling evidence that the contours of our educational system are molded in the shape of the class structure. This reality is at odds with our closely-held belief that schools, especially public schools, are the nurseries of democracy; we hope that schools mitigate social injustice by rewarding merit and excellence. Today, the gap between the wish for a society driven by educational justice and excellence and the reality of a mediocre and un-

just educational system reproducing an unjust society, is as wide and deep as the Grand Canyon.

Because we lack a public philosophy that links educational improvement to a just society, we also lack a public policy perspective powerful enough to begin to fill the chasm between rhetoric and reality. Without a public philosophy, we have no political or ethical center and cannot readily distinguish between enduring reforms, peripheral improvements that make marginal and probably temporary changes, and trivial trendy "breakthroughs" that are irrelevant and often counterproductive. Perhaps it is because of this lack of public vision that we can mistake a minor governance reform like school choice for a core reform; school choice does not go to the heart of the educational matter. Without good schools, choice is meaningless, and we will not create good schools based on weak theories of consumer behavior.

Joseph Viteritti ("Stacking the Deck for the Poor: The New Politics of School Choice," summer issue) is among the most sophisticated school choice advocates in the United States. His analyses are subtle and compassionate, but his policy recommendations are less than compelling because of internal and unrecognized contradictions. He advocates for an equal opportunity model of choice, whereby poor children would be given a voucher at public expense to attend a private or parochial school. If it were not for the awkward facts, this suggestion might seem reasonable. The most glaring awkward fact is that there is not one scintilla of evidence that private or parochial schools do anything

Letters continued on page 48.

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Can Government Nurture Civic Life?

BY E. J. DIONNE, JR.

The United States is experiencing a quiet civic revival. Across the political spectrum, there is a new emphasis on the role of nongovernmental institutions in solving problems and promoting public participation. On the right, the Heritage Foundation's magazine, *Policy Review*, has been recast as a "journal of American citizenship." On the left, *The American Prospect* has engaged in a running debate on civil society. All over the country academic institutions are creating Institutes on Civil Society and Civic Life.

This civic revival is taking place against a backdrop of doubt about America's civic capacities. The landmark work of Robert Putnam traces the decline of civic activity and argues that bold steps are needed to restore civic life. To be sure, not all the indicators of civic capacity are negative, and there is a lively debate over how to read the data. Some conservatives claim that the welfare state has undermined institutions of private generosity and social engagement. From the left—and also from the communitarian camp—comes the lament that consumerism and a culture of consumption have eroded civic commitment. Many in organized labor argue that the long hours people must spend at work have robbed them of the time they once had for church activities, Little Leagues, and PTAs. And of course the understandable desire of women to be paid for their work—and their families' need for their income—has deprived many voluntary and civic institutions of their once-great asset, the unpaid labor of women volunteers.

The civic revival is also a response to a sense of governmental failure, political alienation, and moral unease. For some, the turn to the civic is a way to revive support for and confidence in government; for others it is an alternative to

government itself. In both views, civil society is at once invaluable and irreplaceable by either government or the institutions of the private market. As Alan Wolfe has put it, most citizens live their lives neither "in the government" nor "in the marketplace," but in rich networks built around families and neighborhoods, churches and civic groups, professional societies and sports clubs.

In the coming months a group of us at Brookings will be focusing on civil society. One central issue for us is the government's role in promoting civic life. Can government strengthen civil society, for example by changing the tax laws on charitable contribution or by funneling more of its social spending through civic groups? What are the costs of these strategies? Does government now weaken civil society, notably by taking on problems better addressed by civic and "intermediary" groups?

Virtually everyone engaged in the civic revival debate underscores the central role churches play in dealing with neighborhood breakdown and problems such as crime and teen pregnancy. Can government help churches carry out their civic role? What First Amendment problems would be raised? Would government engagement with churches limit their autonomy and flexibility? The issue is a tricky one, but in poor neighborhoods, government help can be essential to the success of church projects.

This issue is, in turn, linked to the relationship between social and economic capital, especially in inner-city communities. What's obvious is that money alone, whether spent by government or private groups, is no replacement for healthy social and civic networks. But money matters. In most debates about poverty, such assertions quickly develop corollaries.

Poor communities need money; they also need civic organization to take advantage of opportunities. Poverty may be linked to high crime rates, but high crime rates discourage investment and job creation. Poverty is linked with family breakdown; family breakdown leads to poverty. How is one to make sense of this seemingly endless chicken-and-egg debate?

Finally, the rise of the civil society debate has caused important rifts within conservative intellectual and policy circles. Some conservatives use the civil society idea primarily as an argument for dismantling government programs in favor of what Newt Gingrich has referred to as "volunteerism and spiritual renewal." Other conservatives contend that fellow conservatives err if they pretend that simply dismantling the state will bring about the social and cultural changes they seek. Clarifying these differences in emphasis within the conservative debate will be important to the broader discussion over how to strengthen civic life.

The growing interest in civil society and civic capacity is a healthy development for both politics and society. It marks the wide acceptance of the idea that neither democratic government nor a prosperous market can function well absent a healthy civil society. Strong values, social ballast, a sense of trust and loyalty—these come far more from civic life than from either government or the market. What we understand less well is how government and the market can weaken or strengthen civic capacities. For the sake of both democracy and prosperity, the question needs answering. ■

E.J. Dionne, Jr., is a columnist for the Washington Post and a senior fellow in the Brookings Governmental Studies program.



1996

Election





The budget deficit and the economy have become key issues in the presidential campaign and will top the agenda of the next Congress and president. The nation's recent economic record may make this focus seem out of place. The budget deficit, measured as a percent of GDP, has declined for four straight years. It is now one-third what it was in 1992 and lower than it's been in 17 years. The economy, with unemployment well below 6 percent, has been operating at close to full capacity for the better part of two years. Consumer price inflation has been below 3 percent for over four years, the best record since the early 1960s.

But the reasons for the economic focus are understandable. Leaders in both political parties have committed to balancing the budget by 2002. The challenge is considerable because the built-in spending growth of current programs, primarily Medicare and Medicaid, will cause the deficit to begin to grow again in 1997. Policymakers have forsworn a repetition of the tax increases that contributed almost half the deficit reduction delivered by the 1990 and 1993 legislative packages. In fact, they've promised substantial tax cuts. Thus the already big spending cuts needed to balance the budget will have to be even deeper.

Where will the cuts be made? Most of the 1990s spending cuts came from the defense budget, a move made widely acceptable by the end of the Cold War. But a fierce debate has begun over how big a role defense should play in further deficit reduction. Already, the budget requirements of the planned force structure exceed the resources provided in administration and congressional budget plans. Budget pressures offer a compelling reason to ask, as John Steinbruner does in one of the articles that follow, whether a different defense policy and a less expensive force structure could provide for the nation's post-Cold War security.

Henry Aaron and Barry Bosworth describe why balancing the budget over the next six years is just a warm-up exercise for the challenge to come early in the 21st century when the baby boom generation retires. The nation cannot afford to wait until spending on the elderly begins to soar. To avoid a divisive intergenerational struggle in the future, public or private saving must be increased soon to augment the resource base from which the needs of future retirees can be met.

Balancing the budget over the next six years and grappling with the fiscal demands of the baby boomers' retirement would be more manageable if economic growth could be boosted significantly. Unfortunately, as Charles Schultze concludes, various proposals for accomplishing this—incentive-oriented tax cuts, public sector investment, and deregulation—would increase growth only a little.

Reality is inescapable. When the election is over, the winners will face some very tough tradeoffs involving national priorities today and current versus future standards of living.

—Robert D. Reischauer, Senior Fellow,
Brookings Economic Studies Program



PROMISES PROMISES

The Elusive Search For Faster Economic Growth

The U.S. economy has performed superbly in recent years by way of reaching and maintaining both low unemployment and low inflation. But since the early 1970s, long-term economic growth in America has been disappointingly slow. And projections of future growth, including those of the Congressional Budget Office and the administration, foresee no pickup in the years ahead. While most Americans who want to work have jobs, their incomes and living standards haven't been growing much, especially when compared with the halcyon days of the 1950s and 1960s when GDP was expanding 4 percent a year and incomes per family almost 3 1/2 percent.

Not surprisingly, policymakers are looking about for ways to spur faster growth. From all along the political spectrum—from the National Association of Manufacturers to the AFL-CIO, from former Republican presidential hopeful Steve Forbes and GOP vice presidential nominee Jack Kemp to MIT economist Lester Thurow and investment banker Felix Rohatyn—come proposals to alter national economic policies to produce another 1 or 2 percent extra annual growth. (Needless to say, there is no agreement as to exactly what policy alterations are needed.)

If these policies could indeed produce those results, it would be a tremendous boon to the nation. Increasing annual GDP growth from its current 2 percent rate to 3 percent would, if continued for 10 years, add more than \$4,000 annually to the \$40,000 income of the average American family. A return to 4 percent growth would add \$8,000. Notice, however, that a 1 percentage point speedup in growth requires a 50 percent increase and a 2 percent speedup a doubling in the growth that is now forecast!

Faster growth could do more than boost incomes. One percentage point of extra growth would raise federal revenues and lower interest payments on the debt enough to balance the budget at the end of the 10-year period—so long as the growth-promoting policies didn't themselves worsen the budget situation.

What changes in current national policies promise to produce higher growth? How much more growth are they likely to produce? And how much might each help in balancing the budget?

One often-mentioned change involves monetary policy. Current tight Federal Reserve policy, it is said, is a prime obstacle to growth. Whenever economic growth threatens to exceed 2 percent or so on a sustained basis, the Fed has shown itself ready to boost interest rates to prevent the higher growth from being realized. Perhaps a more venturesome policy of credit easing and lower interest rates would produce higher output without setting off inflationary pressures, giving U.S. citizens not only higher incomes, but lower budget deficits as well.

And even if the CBO, the administration, and the Fed are right about *current* limits to growth, perhaps policies could be devised to improve the nation's future growth potential and allow the Fed to relax its caution. One pro-growth policy is a tax cut. A hotly debated issue here is the extent to which the initial

Charles L. Schultze is a senior fellow in the Brookings Economic Studies program. This article is adapted from a chapter in Setting National Priorities, edited by Robert D. Reischauer (Brookings, 1996).

revenue cost of a tax cut is offset by the revenue gains from the faster growth it generates. Two other pro-growth policies are relaxing and improving the economic efficiency of environmental regulation and expanding public investment in education and training.

The Federal Reserve

In times of economic “slack,” when workers and industrial capacity stand idle, a Federal Reserve policy of easy credit and low interest rates can stimulate spending—especially on big-ticket items like housing, cars, and business investment—that puts idle workers and capital resources back to work and causes the economy to expand. But once the nation has reached full employment, more big increases in spending spurred by continued easy money policies will overheat the economy and drive up inflation. Beyond that point the nation’s spending and production can grow on a sustained basis only as fast as its productive capacity, its supply of goods and services, expands. Evaluating Federal Reserve policy, therefore, requires knowing *first*, how much slack there is in the economy and *second*, how fast the economy’s productive capacity is capable of growing.

Full employment—that is, zero slack—does not mean zero unemployment. Even in the best of times some unemployment exists. Millions of young people are looking for their first job, some firms and industries are having to lay off workers who then spend some time searching for a new job, and so on. Stimulating demand for goods, and the related demand for labor to produce those goods, to the point where unemployment is pushed below the full employment level will begin raising the rate of inflation in wages and prices.

Although the rate of unemployment consistent with full employment and stable inflation has varied a bit over time, most economists believe that today full employment is between 5 and 6 percent, and is probably not far from the 5.5 percent unemployment rate of midsummer. But it is at least conceivable that full employment today could be a little below its current level. That being the case, perhaps the Fed should carefully lower interest rates and probe the possibility that unemployment could be lowered a bit further without reigniting inflation. But even if unemployment could safely be reduced by, say, one-half percent, that would produce only a one-time rise in GDP of something like 1 percent. Thereafter GDP would resume its projected 2 percent growth rate. While any noninflationary gain would be welcome, this one-shot increase is a far cry from adding a sustained 1 percent to the annual growth rate. On the budgetary front it would lower the deficit in 2002 from \$285 billion to something like \$250 billion.

How Fast is U.S. Economic Potential Growing?

If the economy does not have enough slack to accommodate a large immediate increase in GDP, is it possible that the economy’s *capacity*—its potential GDP—can grow faster than the 2 percent per year rate envisioned in the standard projections? Unfortunately, the evidence seems overwhelming that under current conditions and policies, the CBO projection

of capacity growth is unlikely to be far off the mark.

The 2 percent projected growth rate consists of a roughly 1 percent annual expansion in labor input and a little over 1 percent a year growth in productivity, or output per worker hour. The strong and steady expansion in labor force participation by women after World War II slowed after 1989, and there is no warrant to assume the earlier growth rate will resume. The labor input projection is likely to be reliable over the next 10–15 years.

Productivity is a little more open to question, but not much. From war’s end until about 1973, productivity grew almost 3 percent a year. Thereafter, despite the information revolution, productivity growth slowed sharply to little more than 1 percent. Economists can explain only part of the decline—the reasons for much of it remain a mystery. But whatever the reasons, the productivity trend has remained remarkably steady for more than 20 years. Not knowing what caused the decline, we can’t be sure productivity growth won’t one day pick up again. But it would be foolhardy to plan national policy on that hope.

Policies to Increase Capacity Growth

If the prospective growth of the nation’s economic capacity puts a lid on what the Federal Reserve can do to raise GDP, could changes in national policy boost capacity growth? Such changes are possible, and I will examine several in a moment. But the cold facts of economic life tell us that no politically feasible policy is going to raise the current rate of economic growth by more than several tenths of a percentage point a year. We should not dismiss the benefits of what look like small increases in economic growth, especially if they persist for several decades. For example, a 20 percent increase in labor productivity growth would lift the overall economic growth rate from 2.1 percent a year to 2.3 percent. Continued for a generation, that increase would raise average family income more than \$2,000 a year in today’s dollars. But the increase in GDP and national income will not generate enough revenue gains to offset more than a modest fraction of the budgetary cost of these policies. To avoid widening the budget deficit, and thereby *slowing* growth, tax cuts or new public investments will have to be matched by cuts in federal spending *over and above* the massive cuts already needed to wipe out the budget deficits now in prospect. Whether the nation is willing to pay the costs and whether the gains are worth paying them are what we should be debating.

Tax Cuts

Federal income tax cuts are an ever-popular way to increase economic growth. Few if any serious supporters of tax cuts today would claim that the economic gain will be so large that the tax cuts will largely pay for themselves. But exactly how much additional GDP would be induced by a supply-side tax cut, and how much of the initial revenue loss would be offset by the revenue yield from that added GDP?

Broad tax cuts can increase growth in two ways: by expanding the labor supply and by stimulating private saving and investment. The critical issue in each case

is how much? Economists measure the responsiveness of labor supply to a tax cut—that is, to higher after-tax wages—by labor’s supply elasticity—the percentage change in labor supply induced by a 1 percent change in after-tax wages. Needless to say, not all studies produce the same answers. It is generally agreed that the elasticity is quite low for men, a good bit higher for married women, and somewhere in between for single women. The elasticity for the labor force as a whole probably lies within a range of 0.2 to 0.33. A 15 percent across-the-board cut in federal income tax rates would raise after-tax wages by some 5 percent. An elasticity of 0.2 would mean a 1 percent increase in labor supply; an elasticity of 0.33, a 1.7 percent increase. Because labor costs constitute a little under 70 percent of GDP, the resultant gain in GDP would lie between 0.7 percent and 1.1 percent. But that would be a one-time gain; thereafter, GDP will grow at the same rate as before but at a higher level.

What about the effects of a tax cut on private saving? Many economists find little effect—“small and hard to find” is how one textbook puts it. One of the higher estimates of the responsiveness of saving to changes in the after-tax return was made many years ago by Michael Boskin (later, chairman of the Council of Economic Advisers during the Bush administration). He estimated that historically a 1 percentage point change in the return to saving in the United States tended to lower consumption spending out of a given income by a little over 2 percent. Using a high response based on the Boskin estimate and a lower one half that size to accommodate the range of views, I estimate that a 15 percent cut in federal income tax rates would raise the private saving rate from its current 6.0 percent to somewhere between 6.15 and 6.3 percent.

The standard economic model of the growth process suggests that a 1 percentage point increase in the share of GDP flowing to saving and then into domestic investment would add about 0.1 percent to the annual growth of productivity and GDP. (If some of the extra saving went into investment overseas, the resulting inflow of earnings from abroad would raise the growth of the nation’s income about the same.) In recent years a “new growth theory,” still much in dispute, has suggested that investment yields a higher return than implied by the standard model. That possibility could yield an increased payoff, with each 1 percentage point increase in the new investment share adding 0.2 percent to the GDP growth rate.

The combination of labor supply and saving increases from a 15 percent tax cut enacted this year would, on the conservative assumptions, raise GDP by 2002 some 0.8 percent above the level it would otherwise reach; on the optimistic assumptions the gain would be 1.4 percent. That gain would expand to a range of 0.8 to 1.6 percent 10 years from now. By 2002 the revenue loss would be \$150 billion a year. The resulting gain in GDP would bring in added taxes of \$20–30 billion. Thus the net cost to the budget of the tax cut would be \$120–130 billion in 2002. If these costs were not matched by spending cuts (over and above those already needed to balance the budget), the deficit would rise, an increased share of private saving

would be diverted to financing that deficit, and private investment would fall. In that case, the tax cut would slow economic growth.

From the standpoint of economic growth, the \$125 billion in spending cuts needed to finance the net cost of a 15 percent tax reduction would be better used to reduce the budget deficit (or if the budget were already balanced, to produce a budget surplus). The spending cuts would reduce the deficit directly and gradually produce further large and growing budgetary savings by lowering interest rates and slowing the rise in federal debt. Initially the tax cuts would produce greater GDP gains. But six years after the spending cuts were fully in place, the gain in GDP from deficit reduction would equal the gain from the tax cut, and thereafter exceed it by a growing amount. After 15 years deficit reduction would add over 3.5 percent to GDP compared with a gain of 1.4 percent with the tax cut.

The package of tax reductions proposed by presidential candidate Robert Dole last July included a 15 percent cut in personal income taxes only, whereas the 15 percent across-the-board tax cut analyzed here applies to both personal and corporate taxes. But the Dole proposal included a 50 percent reduction in the tax on capital gains. There is no reason to believe that the effect on economic growth from the Dole plan would be significantly outside the range estimated above (given the important caveat that the net costs of the tax cuts were fully offset by spending reductions).

Investment In Education and Training

Improving the quality of the workforce through investment in education and training has long been recognized as a spur to economic growth.

The combination of slow productivity growth and declining real wages for lower-skilled men over the past 20 years has called forth many proposals to upgrade education, especially for those who begin work right after high school. Could big public investments in education and training produce what tax cuts cannot, a substantial gain in the level or growth rate of the economy? Again, unhappily, the answer is no.

Well-known labor economist James Heckman has concluded that a good starting point for estimating the payoff to additional public investment in education and training would be to assume that it yields a rate of return of 10 percent—about the same as the return to investment in business capital. The federal government now spends almost \$30 billion a year on education and training (excluding student loans). If it launched a massive increase in that spending, amounting to 1 percent of GDP, its education budget by 2002 would grow to \$130 billion, and extra spending cuts of \$100 billion would be needed to keep the new spending from worsening the deficit. Given the assumption of a 10 percent rate of return, the extra spending would raise the long-term growth of GDP by 0.1 percent a year, about the same as growth-oriented tax cuts of the same magnitude.

Regulatory Rollback and Reform

Arguing that excessive and inefficient regulation depresses economic growth, the Republican Congress set

about in 1995 to redesign and scale back the regulatory apparatus of the federal government, particularly environmental protection. How much added growth can realistically be expected from such a rollback?

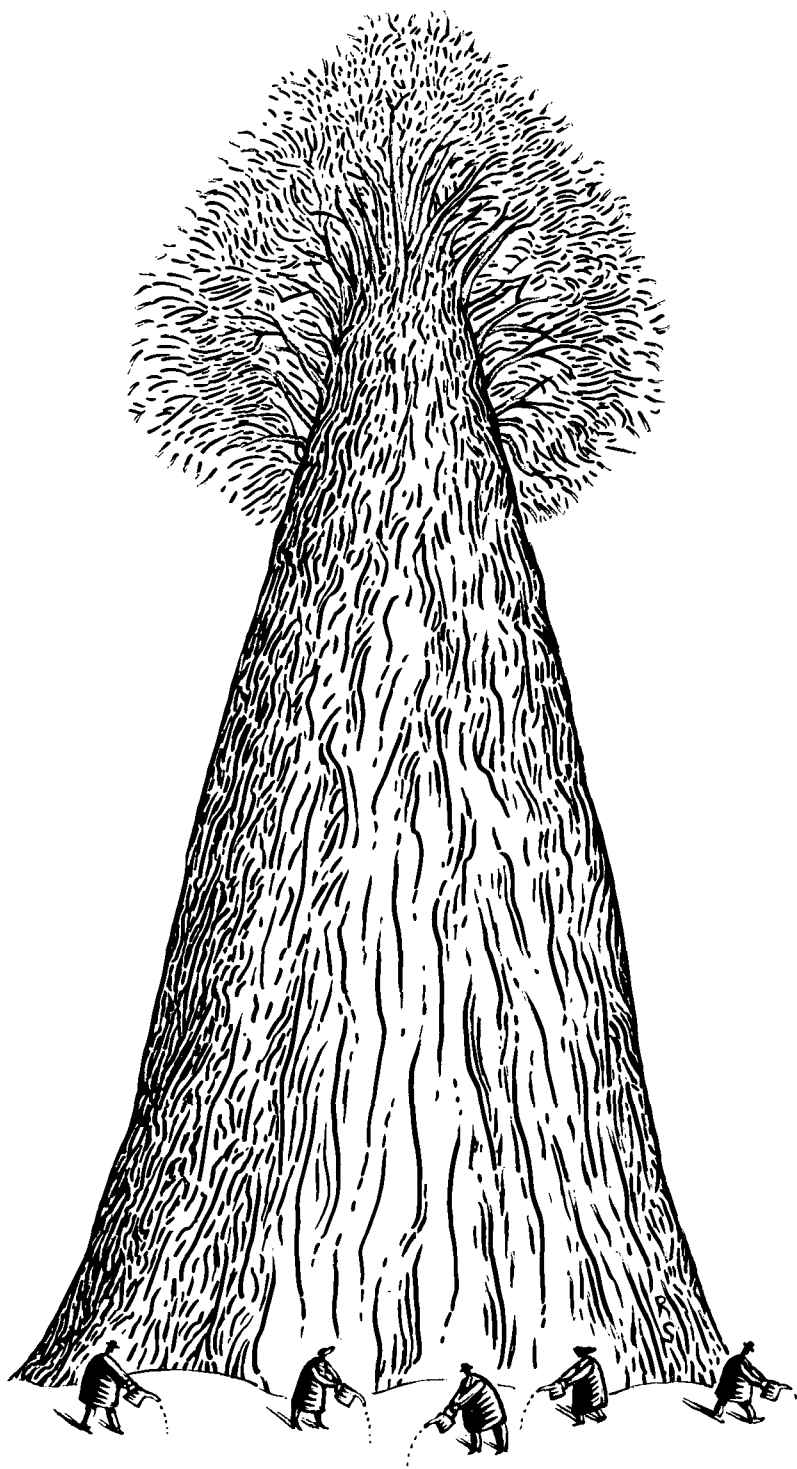
Dale Jorgenson and Peter Wilcoxon have estimated that removing all environmental controls would eventually raise measured GDP by 3.2 percent, as labor, capital, and raw materials devoted to cleanup were shifted to producing the goods and services counted in GDP. Adjusting that estimate to account for statistical peculiarities involving the net economic costs resulting from the mandated installation of emission control devices gives a figure closer to 2.9 percent.

Of course no one proposes scrapping all environmental controls. But costs could be reduced in two ways. First, some environmental laws and regulations have economic costs that well exceed the value of their environmental benefits. Those laws and regulations could be scaled back. Second, relying less on detailed rules and more on economic incentives to control pollution—for example, charging effluent fees or auctioning off effluent and discharge permits—could significantly lower the cost of achieving the environmental goals we do set.

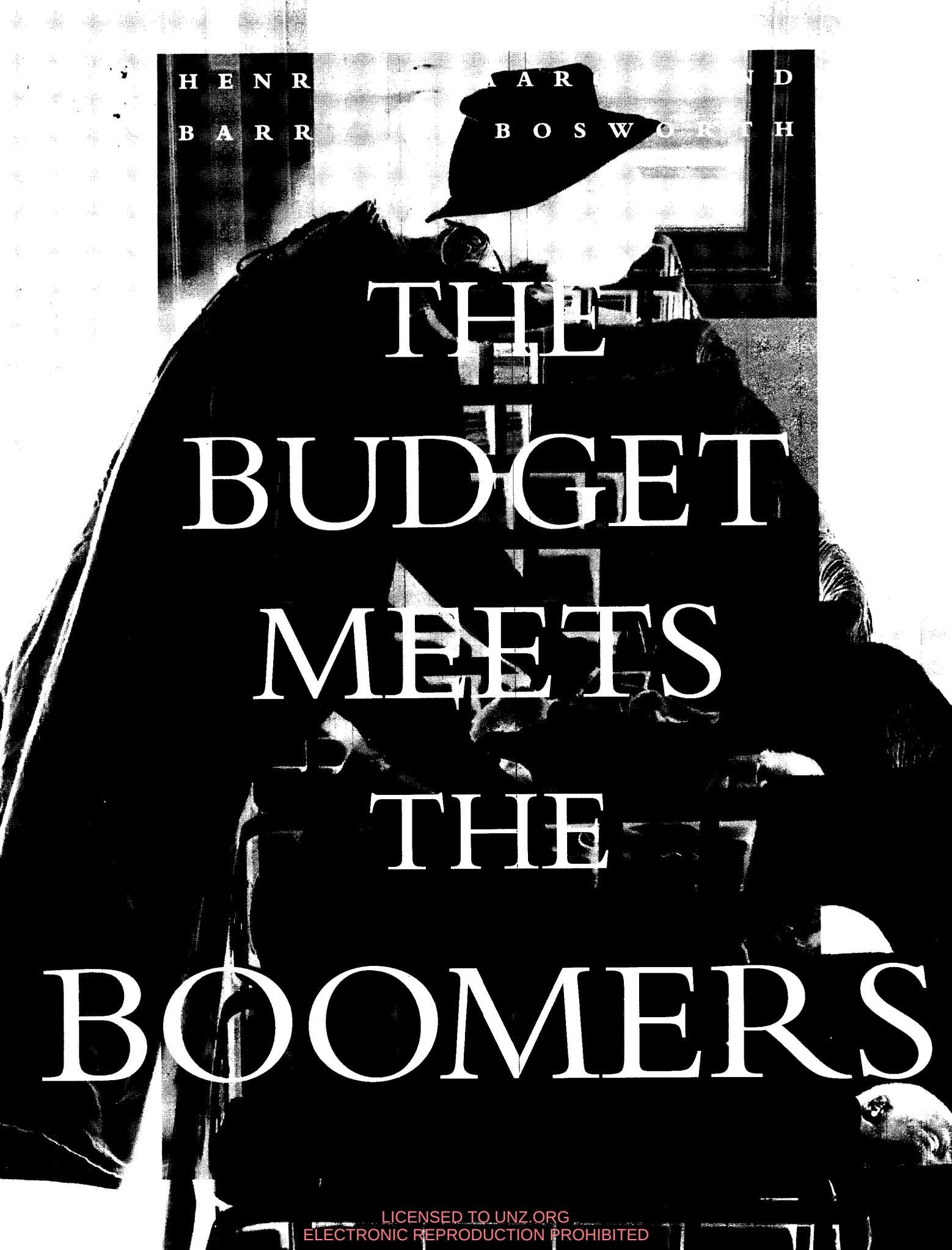
Realistically we should not expect to achieve all the theoretically available saving. It would be impossible to fine-tune the environmental cleanup so as to take *all* actions whose benefits exceed costs and *none* whose costs exceed benefits. Besides, voters have widely differing views as to the value of the benefits. An ambitious target might be to pare the economic costs of environmental regulation by 25 percent. That, according to the adjusted Jorgenson and Wilcoxon estimates, would yield a gain of 0.7 percent in the level of GDP. In turn, realizing most of the gains by the end of 10 years would temporarily raise GDP growth a little less than 0.1 percent a year. After that GDP would grow at its earlier rate but along a higher path.

Promising the Moon

Certainly policies exist that will increase the level or the rate of growth of the nation's economy—but only modestly. Even small increases in economic growth, if they persist for several decades, can boost noticeably the living standards of the next generation. But nothing that is realistically possible, not tax cuts, nor public investments, nor regulatory reform, will generate the large gains that many politicians are seeking—and promising. Moreover, neither tax cuts nor public investments will generate enough economic gain to pay for more than a small fraction of their budgetary costs. To avoid raising the deficit, and thereby lowering growth, they would have to be accompanied by spending cuts over and above the massive ones already required to erase the budget deficit. After witnessing the difficulties and shortfalls over the past two years in nailing down budget-balancing spending cuts, a reasonable person could well question whether now is the time to launch new policies that would, at best, provide small increments to growth, while running the risk of actually lowering growth by worsening the budget deficit. ■



Nothing that is realistically possible, not tax cuts, nor regulatory reform, nor public investments, will generate the large gains in GDP growth the politicians are promising.



HENRY BARRETT AND
BARRINGTON BOSWORTH

THE BUDGET MEETS THE BOOMERS

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

AMERICA'S MOST FAMOUS GENERATION APPROACHES ANOTHER MILESTONE

The aging of America presents the federal budget with long-term challenges that dwarf those raised by the current effort to balance the budget by 2002.

The three federal programs that serve the pension and health care needs of the elderly—Social Security, Medicare, and Medicaid—have replaced national defense as the dominant category of federal budget outlays. They now account for just over 40 percent of federal program outlays but will claim 60 percent by 2025, if maintained in present form. Growth in Social Security spending will claim an additional 1 percent of GDP by 2025. Increased spending on health care for the elderly will claim another 5.1 percent of GDP. Without offsetting tax or expenditure actions, the budget deficit will balloon to 10 percent of GDP.

Contrary to common perception, the problem of aging in America is due not so much to an acceleration in the growth of the over-65 population, as to a slowdown in growth of the workforce. The growth in the number of elderly Americans averaged 2 percent annually between 1960 and 1995. In the next 15 years it will actually slow to a 1 percent annual rate before accelerating to 3 percent between 2015 and 2025 when most “baby-boomers” will be retired. But annual growth in the number of workers, which also averaged 2 percent during the past three decades, is projected to slow steadily to only 0.1 percent annually by 2025.

To date, most discussion of the retirement needs of the elderly has centered on a bleak tradeoff between scaling back the benefits of retirees or raising the taxes on workers. But—though it would require uncommon vision and determination on the part of policymakers—it is possible to prepare for the increased future costs of retirement through a third option: increased saving today. Funding a portion of the future retirement costs with added saving would increase the resources out of which future retirement needs would be met and thus head off what could be a wrenching and divisive debate between the young and the old.

Social Security

Although the projected deficit in the Old Age, Survivors, and Disability Insurance (OASDI) system has attracted the greatest public attention, it is only a small part of the future budgetary problem and, in many respects, the most manageable.

Social Security covers more than 95 percent of the labor force. Its trust funds are financed by a flat-rate employment tax—now 12.4 percent equally split between employers and employees up to a ceiling (equal to \$61,800 in 1995)—and a partial taxation of benefits under the income tax.

Social Security revenues currently exceed costs. The annual surplus, \$70 billion in 1996, is projected to exceed \$80 billion (1996 prices) in 2005. Accumulated reserves are projected to reach a maximum of \$1.3 trillion in 2020, after which the intermediate projections of the Social Security actuaries indicate the costs will begin to exceed annual revenues. According to projections, accumulated reserves will be exhausted by 2030.

Over the 75-year horizon used in Social Security actuarial projections, costs exceed revenues by 2.2 percent of payroll, resulting in a deficit equal to about 14 percent of benefits. Although immediate benefit cuts or tax increases equal to 2.2 percent of payroll would restore the system to actuarial balance over the 75-year horizon, they would lead to enormous surpluses early in the projection period and enormous deficits later on. To keep projected deficits from reemerging and to maintain balance over successive 75-year periods, either the tax rate would have to be increased or benefit payments cut by about 0.5 percentage points every 10 years.

Medicare and Medicaid

Although the costs of Social Security and Medicare are driven by similar demographic forces, spending on Medicare will far exceed that on Social Security, largely because of continued increases in the cost of health care per person. Whereas OASDI benefits per retiree are limited to increases in average wages, the cost of medical care has far outstripped income growth.

Medicare and Medicaid account for the vast bulk of federal health care outlays. Medicare serves roughly the same population as Social Security—people over age 65, the disabled, and those with end stage renal disease. Part A of Medicare, hospital insurance, is financed through an employment tax on OASDI workers, currently 2.9 percent, but without a ceiling on taxable wages. Part B, supplemental medical insurance, is voluntary; about 25 percent of its financing comes from a tax on beneficiaries, the remainder from general budget funds. It covers physician fees, outpatient hospital services, and some prescription drugs. Many retirees also have a supplemental private plan to provide services not covered by Medicare and to finance deductibles and co-insurance charges.

Henry J. Aaron and Barry P. Bosworth are senior fellows in the Brookings Economic Studies program. This article is adapted from a chapter in Setting National Priorities, edited by Robert D. Reischauer (Brookings, 1996).

Political
leaders
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In addition, many elderly people in need of nursing home care can qualify as indigent and receive assistance under the Medicaid program for the poor, which is currently operated with joint federal and state financing. Medicaid accounts for about half of nursing home financing and pays the Medicare premiums for the indigent elderly. In total, the elderly account for about 30 percent of Medicaid outlays.

According to the most recent actuarial projections, the hospital insurance fund will be exhausted in 2001. Annual outlays already exceed income, and the fund has begun to draw down its reserve. Over a 75-year horizon, the actuarial deficit is estimated at 4.5 percent of payroll, twice that of Social Security.

Proposals for Reform

The discussion of potential changes in pension and medical support for the aged to alleviate the projected financing problems has been far-reaching, ranging from simply delaying action until a cash flow crisis necessitates benefit cuts or tax increases all the way to proposals to dismantle the public programs and replace them with private retirement and health care plans.

There are three basic means of responding to the future budgetary problems. The two obvious options—benefit cuts and tax increases—have dominated the public discussion to date and have kept the focus on how to divide a fixed amount of future resources between the young and the old. The broader question of what determines the total amount of those resources has not often been raised.

The third option—advance funding of a portion of future costs—would increase the future resources out of which the consumption needs of both workers and retirees are financed. Current workers could increase their saving to finance an increased portion of their own retirement. That added saving and capital formation would not only directly raise future capital income of retirees, but also increase the wages and taxes of future workers out of which the retirement benefits could be paid.

Such a program could be undertaken under public or private auspices. The current surplus of the existing public retirement system could be expanded, either by increasing the contribution rate or reducing current benefits, with the surplus set aside to add to national saving. Or the increased saving could take place within private retirement or pension accounts. The crucial issue is that the increased saving actually translate into an increase in national saving and not be offset by reduced saving in other public or private accounts.

How Much New Saving?

Saving in the United States, both private and public, has fallen off sharply over the past decade. The national saving rate in 1995 was less than half that of the 1960s. The net private saving rate has dropped from an average of 9–10 percent of net national product during 1950–80 to 7 percent in the 1990s. At the same time, the public sector deficit rose to in excess of 4 percent of NNP in the early 1990s. Although Congress has recently made progress in reducing the deficit, private saving is still far below its historical norm.

How much would saving have to grow to finance the coming increase in the elderly's pension and health care needs? Although spending on the elderly is slated to grow by 6.1 percent of GDP by 2025, the Congressional Budget Office projects that decreased spending in other areas means that total federal program outlays will grow by 5 percent of GDP, from 19 percent in 1995 to 24 percent in 2025. To fund that increase at no cost to future workers, the United States would need to increase its capital stock enough over the next 30 years to raise income 5 percent. Since 1960, the real return on physical capital in the United States, net of depreciation, has averaged about 6 percent, suggesting the need to raise the capital stock by an additional 80 percent of output. For purposes of comparison, the national wealth of the United States in 1995 was about \$19 trillion or 2.8 times GDP.

In practice, the situation is somewhat more complex. First, if all the added saving is invested in the United States, the return on both new and existing capital will fall. Part of the decline is not a problem from a national perspective since total labor compensation would increase as the capital stock rises. But the incremental gain to national income from an additional unit of investment can be expected to fall gradually if capital formation accelerates. This fact further increases the required addition to the capital stock.

The decline in the return to capital could be moderated if some of the increased capital were invested abroad. U.S. residents now earn returns on foreign investments comparable to domestic yields. Thus, some of the decline in the rate of return could be avoided by investing in a larger global economy. Foreign investment, however, raises another problem. Such a strategy would require the United States to convert its current account deficit with the rest of the world into a substantial surplus. Initially, U.S. terms of trade would deteriorate. In other words, export prices would need to fall and import prices to rise to affect the reallocation of trade flows. Thus, only some of the decline in the rate of return can be offset by access to a larger global economy.

The bottom line is this: if national saving is increased by about 5 percent of GDP, the added saving should boost growth enough to raise GDP by the increase in government spending projected over the next 30 years—about equivalent to the decline in saving over the past three decades.

Public or Private Funding?

Funding of the coming increase in the nation's future obligations to retirees could be accomplished either by continuing the current Social Security and Medicare programs or by converting them to private plans. With both the public and the private options the essential question is whether the increment to funding would really add to national saving and capital formation.

Advanced funding would be easiest to implement within the existing public programs because it would leave accrued benefit claims intact. It would require only some combination of an increase in the contribution rate or reduction of benefits to create a reserve, and a firm commitment to set the surplus aside from other

government accounts. From the perspective of the economic benefits to the nation, it also matters little whether the reserve is invested in public or private securities. The economic benefits flow from the increased investment in real capital. If the Social Security fund purchased government debt, a larger proportion of private saving could go to finance investment. If it chose to buy private debt, more of the private saving would be used to cover the public sector budget deficit.

Investment in private securities might help in two respects, however. First, it would diminish the risk that the retirement saving would simply be appropriated to finance spending in other government accounts, as happened with the balanced-budget Constitutional amendment proposed by the congressional Republicans in 1995. Investing the fund in private securities, as is done with state government retirement funds, might help distance its operation from the budget. Second, if the fund restricts itself to government securities, most of its economic benefits will be concentrated in private incomes. And though the added capital formation would raise the incomes of future workers, they would be unlikely to perceive their gains as being the result of increased saving and investment by the prior generation. Thus they could remain as opposed as today's workers to any tax increase. By raising the investment return of the fund, a mixed public-private portfolio eliminates much of the need for future tax increases. Furthermore, concentrating all of the retirement saving in public securities fails to take advantage of the benefits of portfolio diversification. While the fund would face none of the risks of failure associated with private investments, it would be highly exposed to political risks.

Some observers oppose public management of the retirement fund because they doubt that the managers' decisions would be guided solely by investment criteria. They also doubt that the public and its representatives could be educated not to use the reserve to offset deficits in other government accounts. Thus, they support partially privatizing the existing system by moving to individual retirement accounts to reduce the political risks surrounding the current retirement system and allow individuals to manage their own investments. In effect, they propose to move to a two-pillar system: a smaller public component that provides a more minimal poverty-level benefit—perhaps a flat benefit or one related to number of years of participation—and a second defined-contribution pension with no redistributive element. Participants' funds in the individual accounts would be invested in a range of capital market assets, presumably directed by the individual contributors. The plan resembles one introduced in Chile in the early 1980s.

Critics worry that the explicit separation of the redistributive component would result in inevitable pressures to eliminate it, much like the current opposition to welfare programs. Thus, they doubt that the program would provide adequate support for workers with low lifetime earnings. Low-wage workers may also be poorly equipped to make investment decisions. Individual accounts also raise the problem about how to manage the conversion to annuities at time of re-

tirement. It would also be necessary for the government to issue bonds indexed to the CPI to provide a private market means of providing indexed benefits. Many small individual accounts are also likely to increase administrative costs.

Individual retirement accounts have an obvious appeal to well-to-do workers, and they have attracted increased political support in an era when Americans increasingly oppose the redistributive elements of government tax and transfer programs. Since they are effectively defined-contribution pension programs, they eliminate any concern about the public sector costs of the retirement programs—benefits are determined by contributions and market interest rates. But they raise concerns about the consequences for low-wage workers. Most recently, the concept has been carried even further in suggesting that much of the Medicare program should be converted to individual pre-funded accounts.

Will the Opportunity Be Lost?

The expected future costs of the programs for the elderly are high, but if the nation plans ahead they would be manageable. The greatest problem for the United States is that these future liabilities are mounting in the face of a decreased propensity for Americans to save, both publicly and privately. The most effective means of addressing the financing problem would be to shift toward a partial funding of the retirement programs to raise today's saving in anticipation of greater consumption needs in the future.

The controversial aspect of a shift to partial funding is whether it can be done within the current framework of a general public program in which costs and risks are shared or whether it necessitates a shift to a private program where workers own and control their own retirement accounts. Objections to a funded public program spring from doubts that trust fund surpluses would be truly saved, add to national saving, and increase national wealth in future decades. To many, privatization reduces the risk that politicians would appropriate the nest egg for other purposes.

But a public system has many advantages that make it worth a major effort to save. It is progressive in offering larger benefits relative to lifetime earnings for low earners than for high earners, while maintaining a proportionate wage. Its administrative costs are lower than private plans, and it can offer benefits that are indexed for inflation. These features are hard to duplicate in a private system. Privatization has always had an appeal to those who disliked the redistributive aspects of the public program; but recent interest in the funding of future retirement costs has also stimulated interest in privatization.

The likelihood that the United States will adopt a program of partial funding, whether public or private, is low. Thus far, political leaders have been unwilling to confront issues that extend beyond the next elections. It is far more likely that they will ignore this one until the financing problems become more pressing. By then, the option of funding will have passed, and the political battle will return to the divisive one of benefit reductions and tax increases. ■

If they
ignore this
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it becomes
a crisis,
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Problems of Predominance

JOHN D.
STEINBRUNER

BETWEEN 1950 AND 1990 IN PROSECUTING ITS PART OF THE COLD WAR, THE UNITED STATES SPENT A TOTAL OF \$12.4 TRILLION IN 1996 DOLLARS DEVELOPING AND OPERATING ITS MILITARY ESTABLISHMENT — AN AVERAGE OF \$303 BILLION A YEAR.

The effort was motivated by fear of deliberate aggression and was focused on two primary missions: defense of allies in Europe and Asia against invasion of their territory and deterrent retaliation against nuclear weapons bombardment wherever it might occur. Since it was believed that these forms of attack might happen with very little warning, U.S. forces were designed to fight large battles on short notice.

With the dissolution of the opposing alliance that inspired this effort, the United States has reduced its active forces and its annual defense budget by about 30 percent since 1990. But it has continued to focus on the traditional missions of conventional defense and nuclear deterrence and has continued to prepare for rapid reaction to surprise attack. And despite the reductions, the capability to perform these missions has substantially increased. Technical improvements have improved the effectiveness of the force units that have been retained, and the potential opponents now imagined—Iraq, Iran, and North Korea—cannot pose the magnitude of threat once attributed to the Soviet Union. As a result the United States has emerged from the Cold War with a degree of military superiority that is certainly unusual and arguably unprecedented.

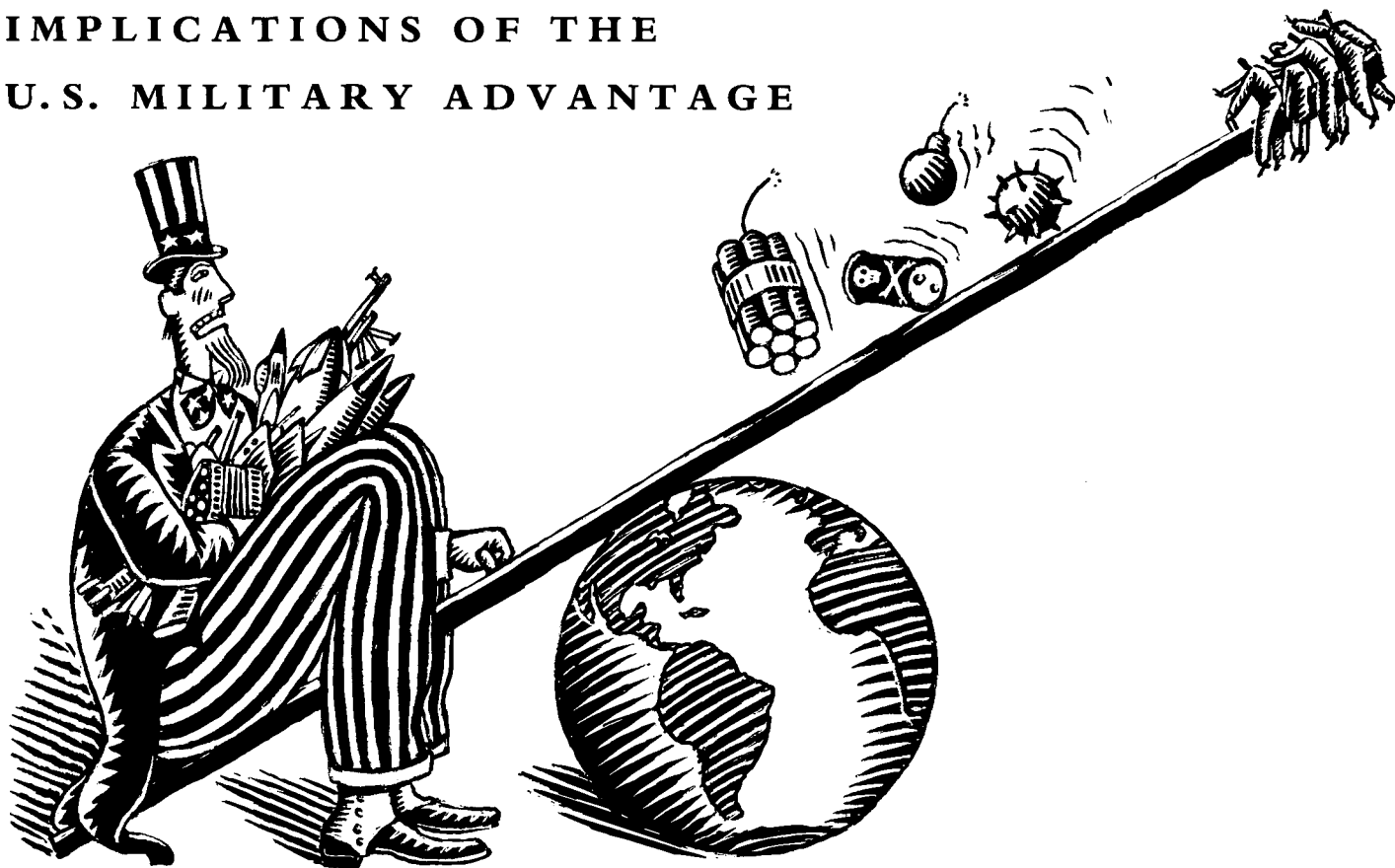
The basis for this superiority is an underlying process of investment that no other country has even remotely matched. As summarized in table 1, China and Russia maintain military establishments that are nom-

inally larger in terms of manpower, but their rates of investment in basic items of military equipment are small fractions of the amounts that support U.S. forces. And the qualitative story is just as stark. The United States has applied advanced information technology and has developed logistical support to a unique extent. Its forces can bring firepower to bear in larger amounts, with greater speed, greater precision, and over longer distances than any of its potential opponents. In fact, no other military establishment is within a decade of attaining a comparable capability, and none as yet is even attempting to do so.

For the citizens of the United States and those of allied countries, this appears to be a comfortable situation and has been broadly popular. Virtually all Americans believe in a strong national defense, and believe as well that our own intentions are benign. Few of us imagine that our superiority would be a valid problem for anyone else. For those who live outside the U.S. alliance relationships, however, and who perceive a risk of serious political disagreement, American military power is inherently intimidating. Their potential reactions give us reason for concern.

Even for the large societies in question—Russia and China—it would not be feasible to match the American standard of military development in less than two decades, and a formal alliance between them would not provide an interim solution. It would provoke a sense

IMPLICATIONS OF THE U.S. MILITARY ADVANTAGE



of confrontation and further stimulate American military investment without actually balancing either the immediate or the potential capabilities of the U.S. alliance system. For Iraq, Iran, and North Korea there is no realistic prospect of acquiring an equitable balance at any foreseeable time. All these countries have an incentive, therefore, to develop means to negate the sophisticated military capabilities they cannot match.

Nuclear weapons are the most effective option in that regard. Just a few of them would be sufficient to wreck a conventional force operation of the sort that the United States mounted in the Persian Gulf War. Since Russia and China can make provisions for such a contingency without any major visible change in their force posture and hence without risking immediate provocation, that can be expected to be their principal reaction to the superior potential of U.S. conventional forces. For the others, however, nuclear weapons are not currently available and efforts to acquire them have already and will continue to provoke active resistance. To the extent that they feel categorically excluded and immediately threatened, as Iraq and Iran both certainly do, their reactions are likely to involve preparations for clandestine sabotage of U.S. forces and deterrent retaliation against the United States itself. Systematic pursuit of offsetting strategies of this sort intersects the realm of terrorism and could seriously aggravate that already serious problem.

In general if the overwhelming firepower of the United States and its allies effectively precludes massive frontal assault, it cannot prevent and may actually stimulate smaller-scale forms of violence that could be

extremely disruptive to globally dispersed military operations and to an increasingly integrated international economy. Traditional military operations of the sort the United States has so elaborately prepared, moreover, are poorly suited to deal with the type of violence that has been most frequently encountered in recent years—that which emerges from the internal disintegration of fractured political systems rather than from a calculus of strategic aggression. Both the desirability and the relevance of traditional military superiority are open to question in the new situation. However proud we may be of our historical accomplishments and however devoted to preserving them, some sharp questions will have to be posed as we evolve our national defense effort.

Troublesome Legacies

Perhaps the most significant question concerns the legacy of rapid reaction to a hypothetical surprise attack. The security logic of the Cold War focused heavily on the possibility of a disarming nuclear attack effective enough to preclude retaliation, and extensive measures were undertaken to protect deployed nuclear weapons from preemptive destruction. Absolute protection of the overall command system necessary to control nuclear forces was extremely difficult to accomplish, however, in terms of direct physical protection. As a means of assuring that retaliation could be undertaken under the worst of circumstances and hence that deterrence could be preserved, the opposing nuclear weapons establishments rigged themselves to disseminate authorization for retaliation immedi-

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Table 1. Force Comparisons

	United States	NATO, Japan, and South Korea	Russia	China	Iraq	North Korea
Military personnel (thousands)	1,438	3,372.5	1,600	2,930	382	1,128
Defense outlays in 1994						
Total (billions \$)	283.2	214.3	40.0	40.0	2.6	5.5
Investment only (billions \$)	114.6	76.1	15.6	14.9	0.8	1.8
Strategic nuclear weapons						
Total warheads	8,205	808	8,625	4	0	0
Army brigades						
Number	36	421.5	237	264	81	120
Annual investment per brigade (millions \$)	547.2	41.8	14.1	26.4	6.4	10.5
Relative investments	1.000	.076	.026	.048	.012	.019
Navy ships						
Major combatants	244	471	334	104	0	28
Annual investment per ship (millions \$)	184.8	13.6	10.1	25.1	0	6.6
Relative investments	1.000	.074	.055	.136	0	.036
Air Force aircraft						
Combat aircraft	1,601	4,819	2,978	4,970	478	770
Annual investment per aircraft (millions \$)	31.1	4.4	2.5	1.1	0.35	0.02
Relative investments	1.000	.1186	.0787	.0354	.0113	.0006
Lift capacity						
Inter-theater aircraft	542	0	595	0	0	0
Million-ton-miles/day	51	0	28.4	0	0	0
Intra-theatre aircraft (C-130)	407	146	222	NA	NA	NA
Million-ton-miles/day	11.2	4.0	2.0	NA	NA	NA
Prepositioning of materiel						
On land (thousands of tons)	484	0	0	0	0	0
At sea (ships)	21	0	0	0	0	0
At sea (thousands of tons)	450	0	0	0	0	0

Source: See the chapter on national defense by John D. Steinbruner and William W. Kaufmann in *Setting National Priorities*, ed. Robert D. Reischauer (Brookings, 1996).

ately upon receiving indication that an attack was under way. The result was an operational posture whereby U.S. and Soviet forces were primed to commit themselves to full-scale retaliation within 20 minutes to beat the intercontinental flight time of a ballistic missile. Despite the declared ending of the Cold War, U.S. and Russian forces are still configured that way. And despite the drastic reduction in nuclear weapons deployments they have mutually agreed upon, the scale of retaliation that each has prepared to undertake would be virtually as lethal to the other society as it would have been during the Cold War.

That is not an inherently safe situation, particularly not for the Russians. It is difficult to preserve authoritative control over the use of nuclear weapons while

also preparing for rapid retaliation, and it requires extensive investment and operational effort to minimize the conflict between these purposes. As reflected in table 1, however, investment resources are extremely scarce for the Russian military. Although their forces are being financed at a small fraction of the U.S. standard, they must somehow preserve basic deterrent capability and adequate conventional defense of their larger and more exposed national territory. If the United States were to launch a surprise attack on Russian nuclear forces, far fewer Russian weapons would survive to retaliate than the United States could count on under the reverse circumstance—a fact that surely makes conservative Russian military planners very uneasy, however implausible one might assume an American surprise attack to be. That imbalance is embedded, moreover, in a larger context of disadvantage. The Russian military could not effectively defend itself against the conventional tactical air assault that NATO members could mount on rather short notice if they chose to do so. Nor could it hold Siberia against a ground incursion from China. Its expressed inclination is to rely on nuclear weapons to cover these traditional security requirements, and the implication is that it would continue to rely on rapid reaction to assure availability of the nuclear weapons.

However well Russian military planners might handle these pressures, the overall security configuration that emerges from their efforts to perform traditional military missions with the resources at their disposal cannot possibly achieve the highest standards of operational safety. In assuring the capacity for retaliation from a position of inherent disadvantage, they will unavoidably set the protections they maintain against accidents, misjudgments, or treasonous intent in handling nuclear weapons at a lower level than they could otherwise achieve. If it is admitted in the aftermath of the Cold War that massive aggression is not the primary problem, then it seems to follow that imposing these choices on the Russian military establishment is not the desirable answer.

Nor does it appear to be wise to drive China into a corresponding set of pressures. China's military development is currently at an earlier stage than Russia's and has not acquired a commitment to rapid reaction. It is evident, however, that China is beginning to upgrade its military establishment, and the longer-term pattern of development will be set by policies the current leadership puts in place. If the logic of international security remains implicitly confrontational, as it now is, the Chinese will adapt to it and will predictably gravitate to residual reliance on nuclear weapons as the Russians have.

Alternative Arrangements

Because the United States possesses the predominant military establishment, our security policies do more than any other country's to set the basic conditions of international security. It is very much in our interest to use this influence, while it is near its peak, to work out a regulated pattern of military deployments that is inherently safer in operational terms and that discourages the offsetting strategies that are akin to terrorism.

The basic means of doing this is to establish reassurance as the central objective and to configure operational forces in a manner designed to preclude surprise attack rather than to enable rapid reaction. If general standards of this sort could be established, there would be an additional benefit of lower cost. A substantial portion of current defense spending is devoted to providing the ready forces required to undertake large engagements on short notice.

Nuclear force operations would be the most important focus of this policy and the aspect of most drastic change. Deployment levels would be reduced in numbers to perhaps half or less of the current agreed ceiling (3,500 warheads) and, even more important, active alert procedures would be terminated. Residual forces would be held under common standards of accounting and physical security that would provide reliable reassurance that none of the warheads was available for immediate use and that a reasonable period of warning would occur if any were to be prepared for immediate use. It is technically demanding but inherently feasible to meet these conditions. If they were achieved, the underlying deterrent effect of nuclear weapons would be preserved essentially intact in that the capacity for annihilating retaliation would be retained, but the risk of an accident, a criminal diversion, or an inadvertently triggered engagement would be significantly reduced.

A transformation of the nuclear weapons posture would undoubtedly have to be accompanied, however, by corresponding reductions and rules of engagement for conventional forces. Although smaller and operationally more restricted nuclear forces would still be able to offset a conventional force disadvantage, the underlying principle of reassurance would require some direct mitigation of that problem. That could be achieved by setting appropriate ceilings on the overall number of conventional force units deployed and on their concentration at any one location. The successful offensive use of conventional forces generally requires concentration at the point of attack. If intimidating force concentrations were not allowed and if conventional force locations were continuously revealed, then the danger of surprise attack and the burden of national defense would be substantially reduced. The international burden of maintaining collective security guarantees would also be reduced. As revealed in the Persian Gulf War, it requires a substantial effort to reverse successful aggression even if the forces undertaking that effort have a decisive advantage. It is a great deal more efficient to stop an attack before it starts, and that basically requires that rules of concentration be defined and enforced.

The process of explicit accommodation required to establish these rules does admittedly involve a difficult evolution of prevailing attitudes. At the end of history's most violent century there are residual political antagonisms and instincts for confrontation that would have to be subordinated to the more refined principle of reassurance. But some powerful incentives encourage the effort. None of the major military establishments is likely to be sustained at current levels. China and Russia will have to reduce their forces substantially if they

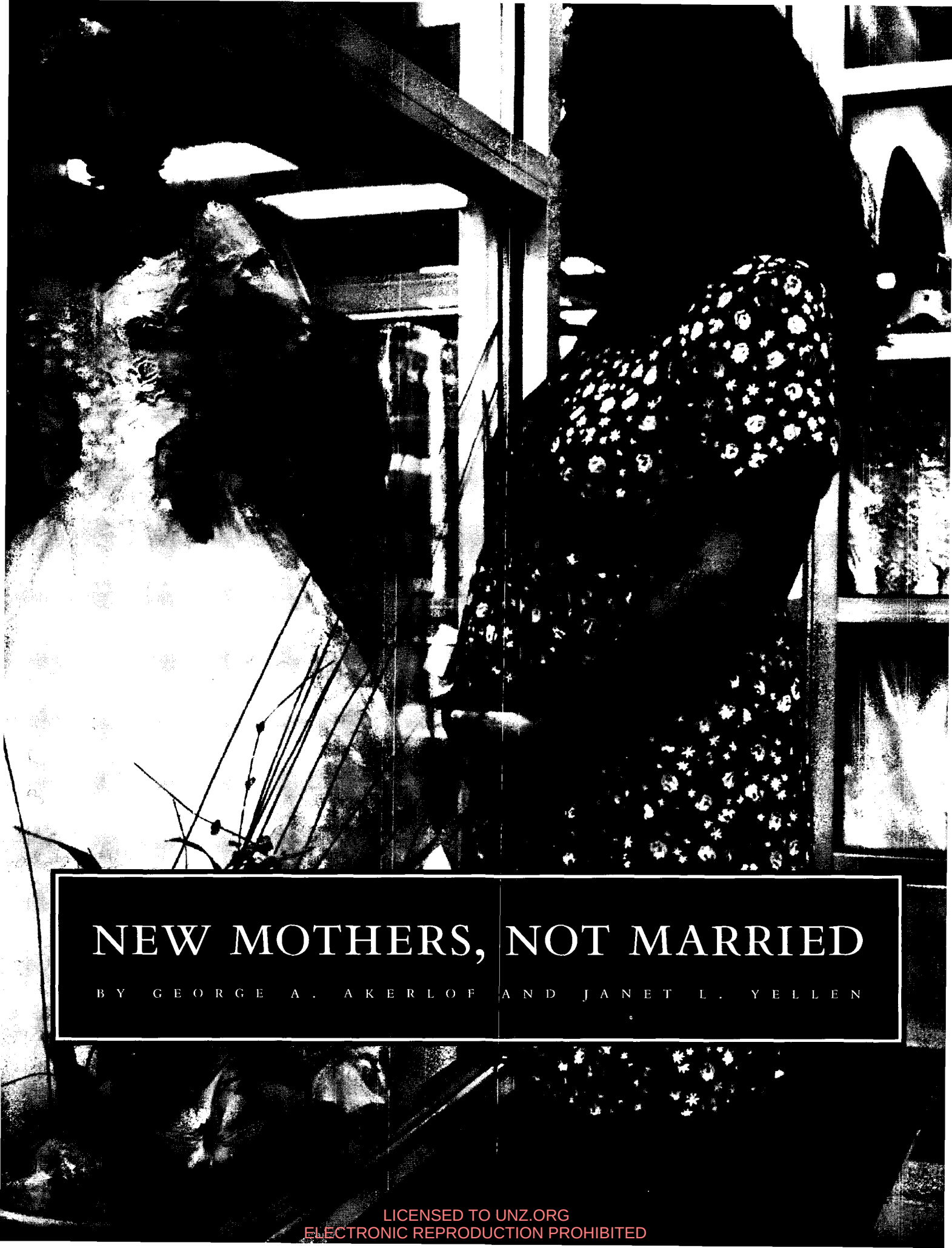
are to have any realistic hope of upgrading their quality to the standards that the United States sets. The United States itself is underfinancing its current forces by some \$70 billion over the five-year planning period and is facing severe fiscal pressures thereafter. These are the principal protagonists whose security relationships have yet to be brought under a regime of systematic reassurance, and all three are driven in that direction by mutual interest in greater operational safety, greater economic efficiency, and greater protection against the dangerous process of weapons proliferation. There is no looming contest over territory or national prerogative sufficiently serious to preclude accommodation. It could happen. With a dedicated effort by the United States, as the stronger party, it probably would.

An outcome can be plausibly imagined a decade hence in which U.S. forces have been reduced to a level that could be indefinitely sustained with an annual defense budget of \$175 billion in 1996 dollars, some 25 percent below what it would require to continue current forces. By explicit agreement Russia and China would have reduced their military personnel to less than half their current levels but would have upgraded their level of investment to about 40 percent of the U.S. standard. Nuclear force operations would have been transformed to the inherently safer pattern, and rules of conventional force operation would be in place to complement agreed ceilings on their size. That arrangement in conjunction with the current U.S. alliance system would provide basic deterrence and territorial defense with less risk and lower cost for all the participating members and would enable them to react to a regional assault by a rogue state just as decisively as they now can. It is a significantly better deal.

Perspective

At the moment most Americans would categorically dismiss this more accommodating international security arrangement on grounds that Russia and China would not agree to it or would not sincerely comply if they did agree. The practical fact, however, is that Russia and China have not been given the opportunity to agree or to comply. The United States has articulated tentative policies of engagement with both countries, but these policies have not been developed to the point that they present a genuinely equitable collaborative security arrangement. The United States is still explicitly hedging against a return to belligerent confrontation and is thereby imposing on Russia and China the requirement to hedge in return.

Eventually this prevailing attitude will have to be seriously reconsidered. The degree of advantage we currently enjoy in performing the Cold War missions might well be sustained for quite some time, but its side effects promise to outweigh its benefits. No country is in fact preparing for the massive assaults that inspired our current configuration of forces. Several are maneuvering to fend off intimidation in a manner that can be generally dangerous. Our current security posture does not correspond to our actual interest or our apparent opportunity well enough to survive indefinitely. We need to think a good bit more about what the end of the Cold War actually means. ■

A high-contrast, black and white photograph of a woman in a floral dress standing in a room. She is positioned in the center-right, looking towards the left. The room features a window with a wooden frame and a plant with long, thin leaves in the foreground. The lighting is dramatic, with strong highlights and deep shadows.

NEW MOTHERS, NOT MARRIED

BY GEORGE A. AKERLOF AND JANET L. YELLEN

Technology Shock, the Demise of Shotgun Marriage, and the Increase in Out-of-Wedlock Births

In 1970 a permanent cure to poverty in America seemed on the horizon. Federal poverty warriors appeared to be gaining ground, and decisions by state courts regarding abortion and by state legislatures regarding the availability of contraception seemed to be giving poor families the tools to control the number and the timing of their children. The dream of eliminating poverty, however, has remained unfulfilled. Not only have U.S. poverty rates stayed stubbornly constant over the intervening 25 years, but also poor families have seen their lot worsen as huge increases in single-parent families—more and more headed by unmarried mothers—have led to the feminization of poverty in America.

Since 1970, out-of-wedlock birth rates have soared. In 1965, 24 percent of black infants and 3.1 percent of white infants were born to single mothers. By 1990 the rates were 64 percent for black infants, 18 percent for whites. Every year one million more children are born into fatherless families. If we have learned any policy lesson well over the past 25 years, it is that for children living in single-parent homes, the odds of living in poverty are great. The policy implications of the increase in out-of-wedlock births are staggering.

Searching for an Explanation

Efforts by social scientists to explain the rise in out-of-wedlock births have so far been unconvincing, though several theories have a wide popular following. One argument that appeals to conservatives is that of Charles Murray, who attributes the increase to overly generous federal welfare benefits. But as David Ellwood and Lawrence Summers have shown, welfare benefits could not have played a major role in the rise of out-of-wedlock births because benefits rose sharply in the 1960s and then fell in the 1970s and 1980s, when out-of-wedlock births rose most. A study by Robert Moffitt in 1992 also found that welfare benefits can account for only a small fraction of the rise in the out-of-wedlock birth ratio.

Liberals have tended to favor the explanation offered by William Julius Wilson. In a 1987 study, Wilson attributed the increase in out-of-wedlock births to a decline in the marriageability of black men due to a shortage of jobs for less educated men. But Robert D. Mare and Christopher Winship have estimated that at most 20 percent of the decline in marriage rates of blacks between 1960 and 1980 can be explained by decreasing employment. And Robert G. Wood has estimated that only 3–4 percent of the decline in black marriage rates can be explained by the shrinking of the pool of eligible black men.

Yet another popular explanation is that single parenthood has increased since the late 1960s because of the change in attitudes toward sexual behavior. But so far social scientists have been unable to explain exactly how that change came about or to estimate in any convincing way its quantitative impact. In recent work we have been able to provide both.

The Answer: No More Shotgun Marriages

In the late 1960s and very early 1970s (well before *Roe v. Wade* in January 1973) many major states, including New York and California, liberalized their abortion laws. At about the same time it became easier for unmarried people to get contraceptives. In July 1970 the Massachusetts law prohibiting the distribution of contraceptives to unmarried people was declared unconstitutional. We have found that this sudden increase in the availability of both abortion and contraception—we call it a reproductive technology shock—is deeply implicated in the increase in out-of-wedlock births. Although many observers expected liberalized abortion and contraception to lead to fewer out-of-wedlock births, the opposite happened—because of the erosion in the custom of “shotgun marriages.”

Until the early 1970s, shotgun marriage was the norm in premarital sexual relations. The custom was succinctly stated by one San Francisco resident in the late 1960s: “If a girl gets pregnant you married her. There wasn’t no choice. So I married her.”

Since 1969, however, the tradition of shotgun marriage has seriously eroded (see table 1 for the trend from 1965 through 1984). For whites, in particular, the shotgun marriage rate began its decline at almost the same time as the reproductive technology shock. And the decline in shotgun marriages has contributed heavily to the rise in the out-of-wedlock birth rate for both white and black women. In fact, about 75 percent of the increase in the white out-of-wedlock first-birth rate, and about 60 percent of the black increase, between 1965 and 1990 is directly attributable to the decline in shotgun marriages. If the shotgun marriage rate had remained steady from 1965 to 1990, white out-of-wedlock births would have risen only 25 percent as much as they have. Black out-of-wedlock births would have increased only 40 percent as much.

What links liberalized contraception and abortion with the declining shotgun marriage rate? Before 1970, the stigma of unwed motherhood was so great that few women were willing to bear children outside of marriage. The only circumstance that would cause women to engage in sexual activity was a promise of marriage in the event of pregnancy. Men were willing

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*How did the
increased availability
of contraception
and abortion early in
the 1970s increase
the out-of-wedlock
birth rate?*

to make (and keep) that promise for they knew that in leaving one woman they would be unlikely to find another who would not make the same demand. Even women who would be willing to bear children out-of-wedlock could demand a promise of marriage in the event of pregnancy.

The increased availability of contraception and abortion made shotgun weddings a thing of the past. Women who were willing to get an abortion or who reliably used contraception no longer found it necessary to condition sexual relations on a promise of marriage in the event of pregnancy. But women who

wanted children, who objected to abortion for moral or religious reasons, or who were unreliable in their use of contraception found themselves pressured to participate in premarital sexual relations without being able to exact a promise of marriage in case of pregnancy. These women feared, correctly, that if they refused sexual relations, they risked losing their partners. Sexual activity without commitment was increasingly expected in premarital relationships.

Advances in reproductive technology eroded the custom of shotgun marriage in another way. Before the sexual revolution, women had less freedom, but men were expected to assume responsibility for their welfare. Today women are more free to choose, but men have afforded themselves the comparable option. "If she is not willing to have an abortion or use contraception," the man can reason, "why should I sacrifice myself to get married?" By making the birth of the child

the physical choice of the mother, the sexual revolution has made marriage and child support a social choice of the father.

Many men have changed their attitudes regarding the responsibility for unplanned pregnancies. As one contributor to the Internet wrote recently to the Dads' Rights Newsgroup, "Since the decision to have the child is solely up to the mother, I don't see how both parents have responsibility to that child." That attitude, of course, makes it far less likely that the man will offer marriage as a solution to a couple's pregnancy quandary, leaving the mother either to raise the child or to give it up for adoption.

Before the 1970s, unmarried mothers kept few of their babies. Today they put only a few up for adop-

tion because the stigma of unwed motherhood has declined. The transformation in attitudes was captured by the *New York Times* in 1993: "In the 'old days' of the 1960s, '50s, and '40s, pregnant teenagers were pariahs, banished from schools, ostracized by their peers or scurried out of town to give birth in secret." Today they are "supported and embraced in their decision to give birth, keep their babies, continue their education, and participate in school activities." Since out-of-wedlock childbearing no longer results in social ostracism, literally and figuratively, shotgun marriage no longer occurs at the point of the shotgun.

The Theory and the Facts

The preceding discussion explains why the reproductive technology shock could have increased the out-of-wedlock birth rate. How well do the data fit the theory?

In 1970 there were about 400,000 out-of-wedlock births out of 3.7 million total births (see table 1). In 1990 there were 1.2 million out-of-wedlock births out of 4 million total. From the late 1960s to the late 1980s, the number of births per unmarried woman roughly doubled for whites, but fell by 5–10 percent for blacks. The fraction of unmarried women rose about 30 percent for whites, about 40 percent for blacks. The fertility rates for married women of both races declined rapidly (also, of course, contributing to the rise in the out-of-wedlock birth ratio).

If the increased abortions and use of contraceptives caused the rise in out-of-wedlock births, the increase would have to have been very large relative to the number of those births and to the number of unmarried women. And as table 1 shows, that was indeed the case. The use of birth control pills at first intercourse by unmarried women jumped from 6 percent to 15 percent in just a few years, a change that suggests that a much larger fraction of all sexually active unmarried women began using the pill. The number of abortions to unmarried women grew from roughly 100,000 a year in the late 1960s (compared with some 322,000 out-of-wedlock births) to more than 1.2 million (compared with 715,000 out-of-wedlock births) in the early 1980s. Thus the data do support the theory.

Indeed, the technology shock theory explains not only the increase in the out-of-wedlock birth rate, but also related changes in family structure and sexual practice, such as the sharp decline in the number of children put up for adoption. The peak year for adoptions in the United States was 1970, the year of the technology shock. Over the next five years the number of agency adoptions was halved from 86,000 to 43,000. In 1969, mothers of out-of-wedlock children who had not married after three years kept only 28 percent of those children. In 1984, that rate was 56 percent; by the late 1980s it was 66 percent.

Unlike the other statistics we have mentioned, the shotgun marriage rate itself underwent only gradual change following the early 1970s. Why did it not change as dramatically as the others? For two reasons. The first is that shotgun marriage was an accepted social convention and, as such, it changed slowly. It took time for men to recognize that they did not have to

promise marriage in the event of a pregnancy in exchange for sexual relations. It may also have taken time for women to perceive the increased willingness of men to leave them if they demanded marriage. As new expectations formed, social norms readjusted, and the shotgun marriage rate began its long decline.

In addition, the decreasing stigma of out-of-wedlock childbirth reinforced the technology-driven causes for the decline in shotgun marriage and increased retention of out-of-wedlock children. With premarital sex the rule, rather than the exception, an out-of-wedlock childbirth gradually ceased to be a sign that society's sexual taboos had been violated. The reduction in stigma also helps explain why women who would once have put their baby up for adoption chose to keep it instead.

One final puzzle requires explanation. The black shotgun marriage ratio began to fall earlier than the white ratio and shows no significant change in trend around 1970. How do we account for that apparent anomaly? Here federal welfare benefits may play a role. For women whose earnings are so low that they are potentially eligible for welfare, an increase in welfare benefits has the same effect on out-of-wedlock births as a decline in the stigma to bearing a child out-of-wedlock. The difference in welfare eligibility between whites and blacks and the patterns of change in benefits—rising in the 1960s and falling thereafter—may then explain why the decline in the black shotgun marriage ratio began earlier than that for whites. Because blacks on average have lower incomes than whites, they are more affected by changes in welfare benefits. As a result, the rise in welfare benefits in the 1960s may have had only a small impact on the white shotgun rate but resulted in a significant decrease in the black shotgun marriage rate.

Policy Considerations

Although doubt will always remain about the ultimate cause for something as diffuse as a change in social custom, the technology shock theory does fit the facts. The new reproductive technology was adopted quickly and on a massive scale. It is therefore plausible that it could have accounted for a comparably large change in marital and fertility patterns. The timing of the changes also seems, at least crudely, to fit the theory.

From a policy perspective, attempts to turn the technology clock back by denying women access to abortion and contraception is probably not possible. Even if it were, it would almost surely be counterproductive. In addition to probably reducing the well-being of women who use the technology, such measures could lead to yet greater poverty. With sexual abstinence rare and the stigma of out-of-wedlock motherhood small, denying women access to abortion and contraception would probably increase the number of children born out of wedlock and reared in impoverished single-parent families. On the contrary, efforts should be made to ensure that women can use the new technologies if they choose to do so.

Finally, if the technology shock theory does explain the rise in single motherhood, cuts in welfare as currently proposed would only further immiserize the vic-

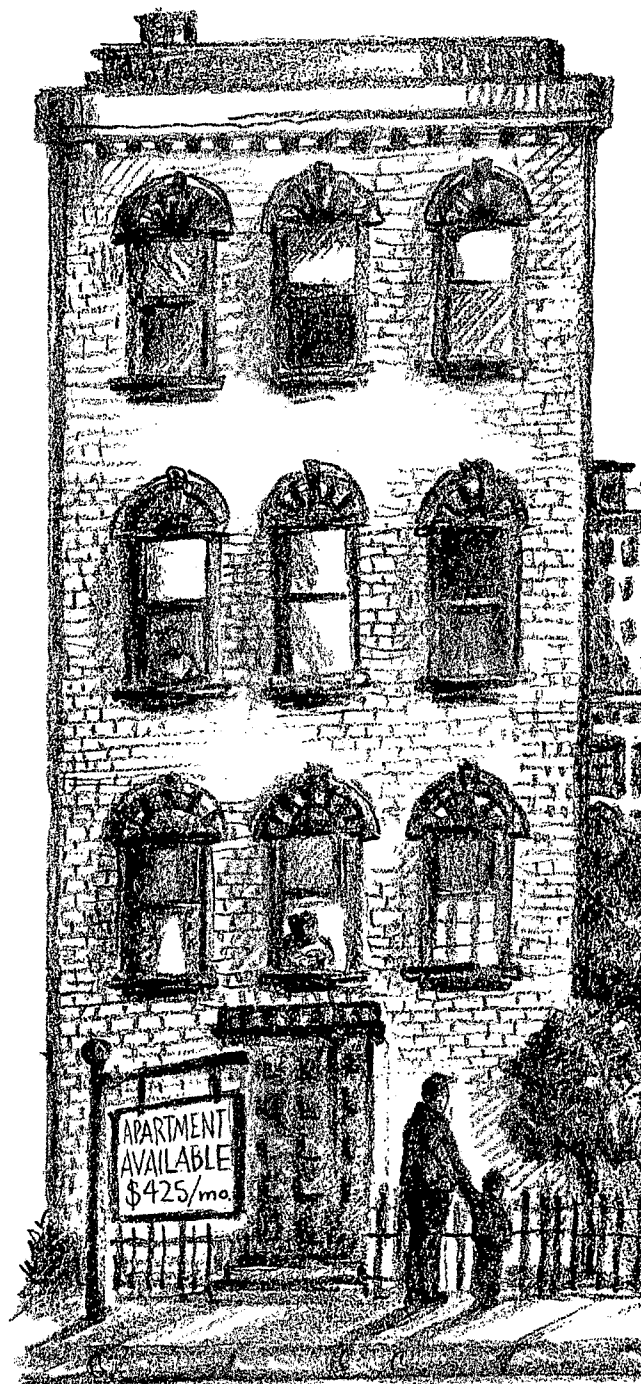
Table 1. America's Reproductive Technology Shock, 1965–84

	1965–69	1970–74	1975–79	1980–84
BIRTHS (THOUSANDS)				
Total	3599	3370	3294	3646
White	2990	2760	2660	2915
Black	542	583	540	590
BIRTHRATES PER 1000 MARRIED WOMEN, AGE 15–44				
White	119.4	103.6	93.1	94.5
Black	129.1	110.3	93.3	90.6
BIRTHRATES PER 1000 UNMARRIED WOMEN, AGE 15–44				
White	12.7	12.6	13.7	18.9
Black	91.0	94.6	85.5	81.7
WOMEN MARRIED, AGE 15–44 (PERCENT)				
White	67.8	65.3	61.6	58.8
Black	55.9	52.9	45.2	39.9
OUT-OF-WEDLOCK BIRTHS (THOUSANDS)				
Total	322	406	515	715
White	144	166	220	355
Black	189	230	280	337
WOMEN AGE 16 WITH SEXUAL EXPERIENCE (PERCENT)				
White	13.8	23.2	28.1	32.8
Black	35.0	42.3	50.8	49.9
UNMARRIED WOMEN USING THE PILL AT FIRST INTERCOURSE (PERCENT)				
Total	5.7	15.2	13.4	NA
ABORTIONS, UNMARRIED WOMEN, AGE 15–44 (THOUSANDS)				
Total	88	561	985	1271
FIRST BIRTH SHOTGUN MARRIAGE RATE (PERCENT)				
White	59.2	55.4	45.7	42.0
Black	24.8	19.5	11.0	11.4
ADOPTIONS (THOUSANDS)				
Total	158	156	129	142
RATIO OF ADOPTIONS TO BIRTHS TO MOTHERS NOT MARRIED WITHIN THREE YEARS OF BIRTH				
Total	49.0	38.4	29.0	19.8

Source: George A. Akerlof, Janet L. Yellen, and Michael L. Katz, "An Analysis of Out-of-Wedlock Childbearing in the United States," *Quarterly Journal of Economics*, May 1996.

tims. Such cuts would have little impact on the number of children born out-of-wedlock while impoverishing those already on welfare yet further. Instead, policy measures to make fathers pay to support their out-of-wedlock children would not only directly contribute to the well-being of children, but also tax men for fathering such children, thereby offsetting at least partially the change in terms between fathers and mothers. Such measures deserve serious policy consideration. ■

Uncle Sam in the Housing Market The Section 8 Rental Subsidy Disaster



JAMES R. BARTH
AND
ROBERT E. LITAN

A potential disaster is brewing in the nation's chief federally assisted private housing program. Over the next seven years, subsidy contracts will expire on more than 700,000 apartment units that receive assistance under the Department of Housing and Urban Development's Section 8 rental subsidy program or its predecessors. The mortgages on these buildings are insured by the Federal Housing Administration (FHA), an agency of HUD. If Congress does not renew the subsidy contracts, owners are likely to default on their mortgages, leaving FHA to pay insurance claims on \$18 billion in outstanding mortgages to the private lenders.

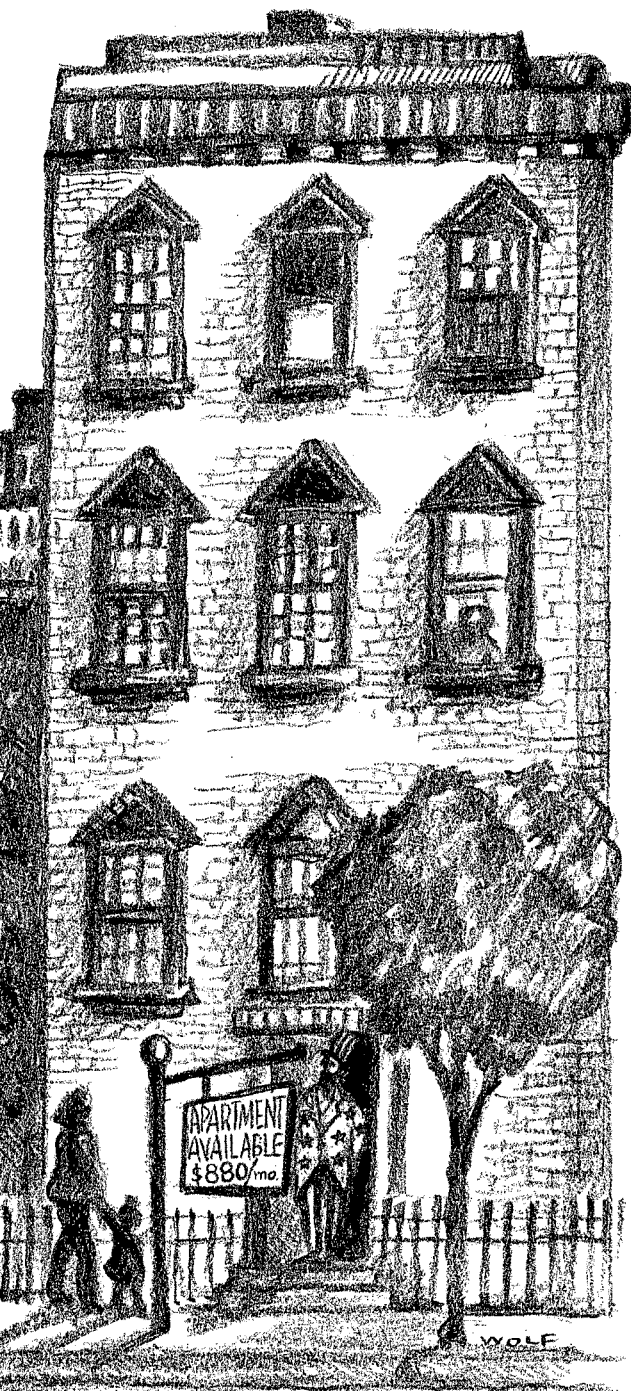
Congress has already targeted HUD for big budget cuts. There is no prospect that these contracts will be renewed at their current subsidy levels. The impending

result is all too obvious. As owners default on their mortgages, the federal government will be stuck with the bill. Meanwhile, hundreds of thousands of low-income families could find their lives disrupted as owners defer maintenance or shut down the properties.

The Clinton administration has called attention to the matter and proposed far-reaching reforms. It estimates that those reforms would, in the long run, save almost \$5 billion in today's dollars. But Congress has yet to address the problem seriously.

What Went Wrong?

The Section 8 program was launched in 1974 by the Nixon administration to encourage more private developers to build housing for low-income Americans. Under the "project-based" Section 8 program, which



expanded earlier efforts along the same lines, HUD entered into rental subsidy contracts with the developers, typically for 20 years. Eligible families pay 30 percent of their incomes toward rent; HUD pays the remainder of the rent directly to the developer. To induce developers to participate in Section 8, FHA guaranteed the mortgages they got from banks or thrifts. Developers also received substantial tax benefits.

Section 8 was popular because it fostered the construction of housing for more than 1 million low-income Americans. But the program involved something of a "Ponzi scheme" element to keep it going. If the subsidies were cut, the scheme would collapse. The owners might default on their mortgages, and the FHA would be left to pay claims. Policymakers acknowledged this flaw in 1983, and HUD stopped en-

tering into new Section 8 contracts with owners. Instead, HUD began assisting tenants directly with portable vouchers, in the process both providing tenants more choice and lowering the per-person cost of housing assistance. Today some 1.5 million American households use portable vouchers to help pay their rent.

But what happened to all those pre-1983 properties with subsidy contracts? When they were new, most provided excellent quality housing, though often at an excessive cost per unit. Even today, most provide decent housing. But, as they aged, many ran into financial and operating problems. For years, HUD and Congress kept the Ponzi-like scheme going by layering on added subsidies when projects got into financial trouble.

But the situation couldn't last and it won't. The problem is that roughly two-thirds of the properties are now *over-subsidized*—they receive federal subsidies based on rents *above* those on comparable non-subsidized units in the same neighborhood. The over-subsidization problem grew slowly as many owners ran up costs—costs that the program gave them little incentive to control—and thus required larger subsidies to keep their projects afloat. But it has now taken on serious proportions. More than 40 percent of the properties now have assisted rents exceeding 120 percent of average market rents in their locations. The General Accounting Office has found Section 8 apartments renting for twice as much as non-subsidized apartments across the street. In Casper, Wyoming, for example, two-bedroom subsidized apartments rent for \$880 a month, while larger unsubsidized apartments with more amenities rent for as little as \$425 a month. Even worse, some tenants would like to leave the complex—for more satisfactory housing at lower cost to the government—but cannot because their rental assistance is tied to their current units.

It makes no sense to pay owners more than they would get in a free and competitive market. The only reason the practice has continued is policymakers' fear that many owners would have to default on their mortgages if their subsidies were capped at market-level rents.

Some observers argue that the current system needs only some fine-tuning to lower costs. But the system's two fundamental flaws do not realistically permit such optimism. First, the interlocking subsidies of mortgage insurance and rental assistance insulate Section 8 properties from market forces. And, second, because the rental assistance is tied to specific units, HUD cannot walk away from the properties: it must absorb any cost increases. In effect, the system creates two hostages: tenants to their units and the federal government to keeping the system afloat.

Proposals to control subsidy costs through better enforcement or tighter funding formulas will fail to eliminate all inefficiencies because they require a continued bureaucratic structure to administer the program. Market rent levels, which send the proper signals to owners and tenants, can be achieved only through competition, not by government fiat.

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Efforts at Reform

Early in 1995 HUD proposed replacing the expiring Section 8 contracts with portable housing vouchers and leaving landlords free to rent their units for whatever the market would bear. To assist property owners in the transition, FHA would agree to write down, *in advance of default*, the mortgages in those cases where market rents could not cover operating costs and mortgage payments and to take the “hit,” paying out claims. But HUD’s proposal was opposed by both property owners and tenant groups. Some owners feared that HUD would treat them unfairly in the renegotiation process and were concerned that the mortgage writedowns themselves would trigger a tax liability. And despite HUD studies showing that more than 80 percent of voucher recipients find suit-

Moving to a system of vouchers would give low-income tenants in Section 8 housing the same freedom to move that is enjoyed by everyone else in this country.

able housing, some tenants’ organizations worried that many residents, especially minorities, the elderly, the handicapped, and those with large families, would be unable to find adequate housing in other buildings. Tenants were also distrustful of assurances from HUD that elderly and handicapped families, in particular, could remain in their units under any voucher plan.

Because the high-cost Section 8 contracts expiring in 1996 covered fewer than 1,000 units, Congress elected to put off facing the problem squarely. It did not, however, pass the buck completely. It renewed the high-cost subsidies only for one year and gave HUD authority to “demonstrate” the benefits of restructuring the program and writing down mortgages before default on 15,000 units. But the demonstration expires at the end of September 1997 and thus leaves more than 700,000 units awaiting action—236,000 units expiring in 1997.

This year HUD and the administration have recommended “Portfolio Reengineering,” a scaled-down approach to addressing the impending Section 8 disaster, one that tries to avoid some of the objections made by owners and tenants last year. The new proposal would reduce excessively generous rents to market levels and offer opportunities to local communities to make future subsidies portable, thereby giving tenants more choice. Meanwhile, HUD would gain negotiating authority with respect to the mortgages on the over-subsidized properties, saving the government money on subsidy payments.

To meet objections to vouchers from both tenant groups and owners, HUD proposes to give state and local governments a say in the decision whether, and at what pace, assistance now tied to individual properties should be converted to portable vouchers. In some cases, for example, a community may decide that continued project-based subsidies are necessary to ensure a neighborhood’s stability.

HUD also recognizes the tax difficulties that renegotiating mortgages creates for owners. Without explicitly outlining how to deal with the problem, it has expressed a “willingness” to discuss with Congress ways to take account of it. The most likely solution would defer recognition of any capital gains from mortgage writedowns until the properties are sold to another party, provided the FHA insurance is extinguished and the rental subsidies are restructured. There is a good argument that such tax relief would not widen the budget deficit, since FHA would have to accept larger writedowns if owners were not given capital gains tax relief and were able to resist restructuring.

The new Portfolio Reengineering proposal would also permit property owners to apply for FHA insurance on their newly restructured loans. The insurance would be properly underwritten based on the new conditions and scored as a subsidy under current “credit subsidy” budget accounting rules.

Initially, HUD envisioned renegotiating the thousands of mortgages, one by one, with the owners. It has since realized the daunting nature of this task. It also considered—and then rejected—simply selling the mortgages to third parties to let the market set the writedowns. But this approach would have required the owners of the restructured properties to default first. Instead HUD now proposes to transfer, at competitive prices, its guarantee liabilities on a designated portion of the FHA-insured mortgages to competitively selected third parties. A wide variety of entities, alone or acting as teams, would be eligible: local and state governments (including state Housing Finance Agencies), nonprofit organizations, private asset managers, and any number of potential capital partners. These entities would then negotiate with lenders and owners to restructure the mortgages, or sell them, depending on the circumstances. These earlier interventions managed by third parties are expected to be more efficient in restructuring mortgages than later interventions by HUD. All Section 8 contract obligations and rights would be honored, including the protection of tenants.

Using a trust structure, HUD and the third parties would share in the proceeds to the extent that the third parties can do better than the government in restructuring the mortgages and managing the government’s liabilities. This way, HUD would ensure that the third parties not be given windfalls; meanwhile, HUD’s share of the proceeds would help rehabilitate dilapidated properties. To make sure the third parties have the right incentives to get the best deals and minimize costs, they would have to pledge some of their own capital to participate.

The scaled-down Portfolio Reengineering proposal

Under-subsidization Is a Problem Too

When the Section 8 program was begun in 1974, it replaced an older system of subsidized project-based housing. The properties built under the pre-1974 regime have their own set of problems, the primary source of which, ironically, is that many (as many as 60 percent, according to a recent estimate) are *under-subsidized*—the rents and subsidies property owners collect are *below* market levels. As a result owners are unable and unwilling to keep the properties well-maintained and often simply let them deteriorate. Indeed, more than 80 percent of these properties have deferred maintenance and capital needs of more than \$5,000 per unit. Some units are crime-ridden, poorly located or constructed, and perhaps no longer viable. But if the incentive structure of the pre-1974 program were changed quickly, much of this housing could be refurbished and made livable.

HUD's most recent Section 8 proposal does not address the problem of disincentives for investment in the older properties, which make up about 80 percent of the contract expirations over the next three years and half of the overall total. But when Congress gives HUD authority to restructure the mortgages on Section 8 rental subsidy contracts, it should extend the authority to include under-subsidized units as well. If Congress does not act, tenants in these units must continue to suffer the consequences of delayed maintenance.

The current HUD proposal leaves unresolved the issue of whether tax benefits accruing to owners of subsidized rental units when mortgages are restructured should be conditioned on owners making new investments in their properties. The issue is less important for the newer Section 8 properties, which are generally in better physical condition than the older properties. But if HUD is given authority to renegotiate the mortgages on the deteriorating older units, some element of "new investment" conditionality makes sense.

is estimated to save taxpayers almost \$5 billion in reduced rent subsidies and FHA claims payments.

It Is Time for Congress to Act

The demonstration project that Congress approved last year is far from enough. Congress must fix the *whole* Section 8 problem. As noted, subsidy contracts on approximately 236,000 units, or about a quarter of the entire Section 8 portfolio, will expire in 1997. Contracts on an additional 246,000 units will expire during 1998 and 1999. HUD's latest proposal is a good place to start. At this writing, there is hope that congressional appropriators may authorize HUD to restructure mortgages and assistance on projects whose Section 8 contracts expire in fiscal 1997 and whose rents are above market.

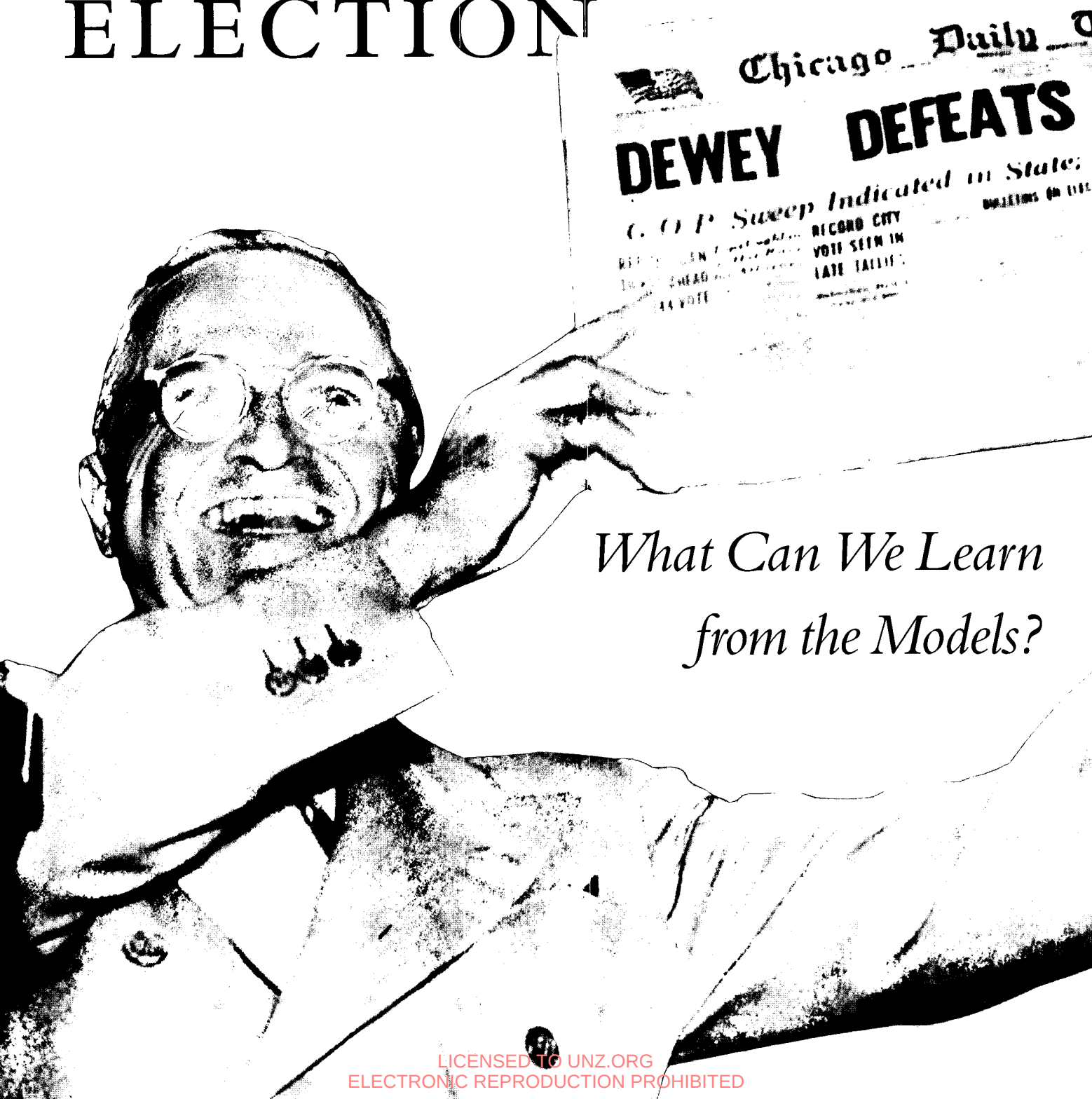
Simply renewing expiring contracts for another year, as Congress did last year, will accomplish little. Subsidy costs will continue to go up while properties deteriorate. The longer Congress persists in an incrementalist strategy, the more costly defaults will ulti-

mately be. In addition, continuing to renew expiring Section 8 contracts at their existing, over-subsidized levels leaves ever fewer resources for all HUD's other housing and community development needs.

Ideally, Congress should not stop with the administration's latest scaled-back proposal. It should move the entire Section 8 program toward a system of vouchers. Not only are vouchers less expensive than the current bureaucratic system of subsidies, they would give Section 8 tenants the same freedom to move that is enjoyed by everyone else in this country.

Before he announced his resignation from the Senate last spring, Majority Leader Robert Dole announced his support for a policy to "end public housing as we know it" by giving all public housing residents vouchers to enable them to live wherever they choose. HUD Secretary Henry Cisneros made much the same commitment last year. If Robert Dole and the Clinton administration can agree on this proposition, then it is time for Congress to agree to it as well. ■

FORECASTING THE PRESIDENTIAL ELECTION



*What Can We Learn
from the Models?*

The search for order in a seemingly chaotic and volatile political world is perfectly understandable. The unceremonious reversals of fortune suffered in recent years by George Bush, Bill Clinton, and Newt

Gingrich suggest the tenuousness of political advantage and the risks of simple extrapolations from the present to the future. The pattern of media coverage of presidential elections, which chronicles every unforeseen event and strategic choice by the candidates and their handlers and analyzes every blip of reaction in public opinion, reinforces the impression that each election is in flux and wildly unpredictable.

So it is not surprising that election forecasting has garnered increasing attention. Over the past several election cycles, scholars have churned out a dizzying array of models that purport to capture the underlying structure of past presidential elections and, on that basis, to predict the outcome of the election that lies some months in the future.

Reactions to the forecasts have ranged from reverence to ridicule. Yale University economist Ray Fair gained prominence based on the accuracy of a model he developed in the late 1970s to forecast presidential elections during the 1980s. The convergence of Fair's model and several newcomers around George Bush as the projected winner at a time in 1988 when Michael Dukakis was enjoying a healthy lead captured the fancy of journalists and lent a new respectability to forecasting. But that elevated standing was cut short by the well-publicized failure of two of the models (including Fair's) to anticipate Bill Clinton's comfortable 1992 victory. Soon skeptics were treating forecasts as curiosities on a par with such reputed election bellwethers as which league won the World Series and whether fashion hemlines were going up or down.

We come neither to praise election forecasting nor to bury it, but to explore whether the enterprise does in fact shed light on presidential campaigns and elections. Certainly forecasters have grounds for humility. Building models based on a small number of elections, involving questionable assumptions and rough measures of only a few of the factors that may affect specific election outcomes, they produce forecasts that often have wide confidence intervals and can be highly sensitive to specification choices. It doesn't inspire confidence to see data mined and equations refitted in the aftermath of inaccurate forecasts. But there are reasonable standards to use in judging the utility of various models, from the accuracy of out-of-sample forecasts to the plausibility of the underlying theory of individual behavior and the stability of the estimated effects over time. By using these standards in reviewing recent experience with these models, we can draw useful lessons about presidential elections and provide some baseline expectations with which to view the final months of this year's campaign.

The Lessons of Presidential Election Forecasting

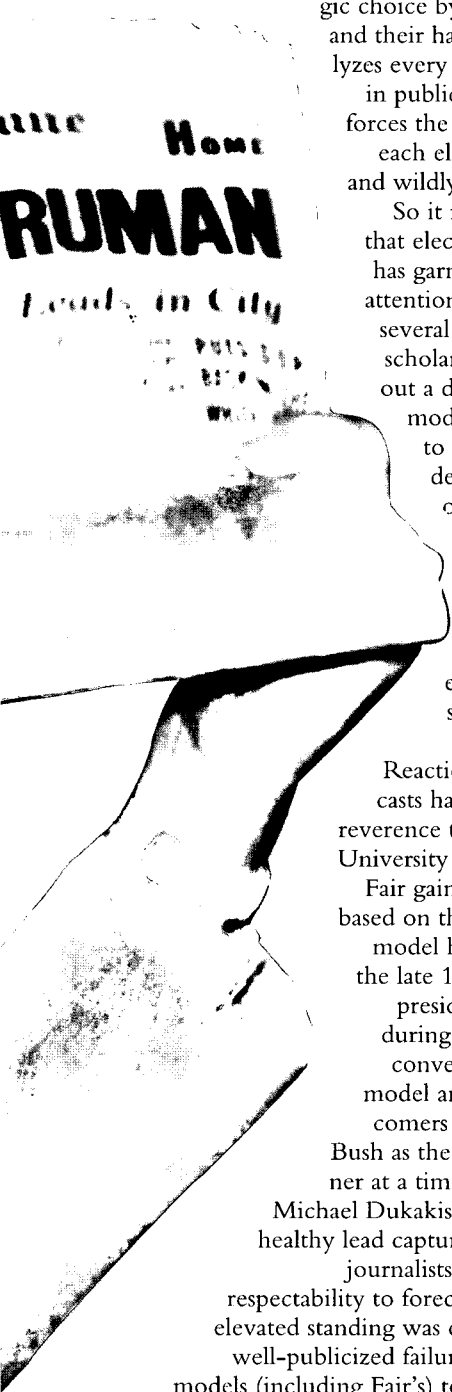
1 *The fundamentals of a presidential election are in place before the traditional beginning of the general election campaign on Labor Day.*

This is not to say that the election is over before the campaign begins or that idiosyncratic events throughout the campaign make no difference. But forecasting models can succeed—and several have been quite accurate—because the critical factors affecting a presidential election are in place before the fall campaign begins. Among the fundamentals are the general course of the economy, the advantages of presidential incumbency, and, most important, the predisposition of the electorate toward the candidates. Before the fall campaign gets under way, a critical mass of voters has either already decided on a candidate or is strongly predisposed toward one.

Election forecasting offers a useful lesson about when polling becomes meaningful in a presidential election. In keeping with conventional wisdom, early polls should be taken with a grain of salt. The opinions they register are so ephemeral as to offer no real clues about the election. In the 12 presidential elections since 1948, for example, the leader in June Gallup Polls won 7 times and lost 5. But, as the successful forecasting models have discovered, between early summer and the fall campaign, public opinion gels. Whereas May and June polls are of, at most, marginal forecasting value, late July to early September polls tell us a great deal. By then, public opinion has firmed up, and what hasn't yet firmed up can be accurately predicted. The track record is clear. In the 12 elections from 1948 to 1992, when the party controlling the White House had a July presidential approval rating exceeding 50 percent, it won. When the approval rating was below 50 percent, the "in-party" won only once—the much ballyhooed come-from-behind victory of Harry Truman in 1948. The pattern in preference polls is much the same. Every nominee since 1952 who led by more than 53 to 47 in the post-convention polls has won the November election.

**JAMES E.
CAMPBELL
AND
THOMAS E.
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Home
TRUMAN
Leads in City

Table 1. The Battleground States: States That Voted for Bush in 1988 and Clinton in 1992

STATE	MEAN TWO-PARTY DEMOCRATIC VOTE, 1988 AND 1992	ELECTORAL COLLEGE VOTES	CUMULATIVE ELECTORAL VOTE	
			REPUBLICAN	DEMOCRAT
18 Republican states	42.5	168	168	538
New Hampshire	43.7	4	172	370
Georgia	45.1	13	185	366
Nevada	45.5	4	189	353
Tennessee	47.2	11	200	359
New Jersey	47.3	15	215	338
Ohio	47.8	21	236	323
Kentucky	48.0	8	244	302
Louisiana	48.7	9	253	294
Montana	49.4	3	256	285
Colorado	49.4	8	264	282
Delaware	49.5	3	267	274
Maine	50.2	4	271	271
Michigan	50.4	18	289	267
Connecticut	50.7	8	297	249
New Mexico	51.3	5	302	241
Pennsylvania	52.2	23	325	236
Missouri	52.3	11	336	213
California	53.4	54	390	202
Maryland	53.4	10	400	148
Illinois	53.7	22	422	138
Vermont	54.2	3	425	116
11 Democratic states	57.9	113	538	113
+ District of Columbia				

Note: The solid Democratic and Republican states were those that voted in both 1988 and 1992 for the same party. Arkansas, as Clinton's home state, was also added to the Democratic base. The 18 Republican states are Alabama, Alaska, Arizona, Florida, Idaho, Indiana, Kansas, Mississippi, Nebraska, North Carolina, North Dakota, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia, and Wyoming. The 11 Democratic states are Arkansas, Hawaii, Iowa, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Washington, Wisconsin, and West Virginia. The cumulative electoral vote counts are the number of electoral votes that a party would win if it carried the specific state plus all of those leaning more in its direction. For instance, if Dole carried Michigan and all states that had on average voted more Republican than Michigan in the 1988 and 1992 elections, he would have an Electoral College majority of 289 votes to 249 for Clinton.

2 *Third-party and independent candidacies generate noise, but do not affect an election's predictability.*

It is certainly reasonable to question whether presidential elections can be forecast accurately when a significant third-party or independent candidate is involved, but the track record is again clear. The forecasting models most accurate in predicting the two-party presidential popular vote are equally accurate whether outside candidates receive a significant vote or only negligible support. In fact, the mean out-of-sample errors of two leading models were smaller when outside candidates won a larger portion of the vote (1968, 1980, and 1992). This is not to say that third parties make it easier to predict elections or that they might not someday have greater effects on a two-party con-

test, but, at least to date, they have not been an impediment. Presumably, the reason the strong independents—George Wallace, John Anderson, and Ross Perot—did not confound the forecast models was that each drew support fairly evenly from both major parties and attracted the rest of their support from voters who otherwise might not have voted.

3 *Campaigns narrow the lead of front-runners.*

The presidential race almost always tightens up over the course of the campaign. In 10 of the 12 elections since 1948, the front-runner's lead in June has notably declined or evaporated by election day. The two exceptions, both working to the advantage of incumbents seeking reelection, were in 1972 when Richard Nixon widened his lead over the ill-fated George McGovern and in 1984 when Ronald Reagan extended his lead over Walter Mondale.

Campaigns narrow the front-runner's lead for many reasons. Once the campaign heats up, any recognition advantage that either candidate might have had disappears. Excepting the incumbent's Rose Garden strategy, the playing field is nearly level. Both candidates have plenty of money, good advisors, and loads of media coverage. Whatever party divisions plagued a candidate on his way to the nomination can heal through the convention and into the campaign. For instance, after the bitter 1968 Democratic Convention in Chicago, Hubert Humphrey trailed Richard Nixon by 12 points in the polls. By election day the gap had closed to a single point. Leads also close because big leads simply cannot be sustained. Two-party politics is too competitive to preserve wide margins, as campaigns activate the underlying partisan attachments of voters. Add the media's closer scrutiny of front-runners and their desire for a real contest, and leads are bound to erode.

4^A *It's more than the election-year economy.*

Long before James Carville phrased it in his own refined way—"It's the economy, stupid"—politicians and analysts had fully appreciated the political consequences of the economy. Herbert Hoover and Jimmy Carter learned this lesson the hard way. But the key question is timing. When does the economy matter? Here we can learn from Ray Fair's heralded forecasting model, which was built primarily on presidential incumbency and election-year economics, and which overestimated George Bush's 1992 vote by 9 percentage points. In evaluating the wreckage, Fair concluded that voters must have a longer-range view of the economy. Election year 1992 was not such a bad one economically, but voters may have blamed Bush for slow growth during 1990–91. In a similar vein, Christopher Wlezien and Robert Erikson find predictive power in income growth over the president's term. A longer perspective is also implicit in the James Campbell/Kenneth Wink and Alan Abramowitz models that rely more heavily on public opinion for their forecasts. In

short, voters do not suffer from economic amnesia. They may not recall the details, but they know whether the economy has been on track for the past few years. And voters may not look just to the past: a revised model by Michael Lewis-Beck and Charles Tien suggests that elections are also predictable based on public evaluations of which party will better maintain prosperity in the future.

4^B Voters are not cash registers.

While the economy unquestionably matters greatly and helps color the general mood of a campaign as favorable or hostile to the party controlling the White House, it is not the sole, and may not even be the most important, determinant of an election. Voters always identify economic problems as important, but they also cite a range of noneconomic problems from crime to the environment to civil rights to the size of government.

Again, the Fair model is instructive. All the major forecasting models include the economy, but Fair relied most heavily on it and excluded measures of public opinion—and missed the 1992 election results by a mile. In the Abramowitz and Campbell/Wink models, the most accurate in 1992, economic conditions directly accounted for about a third of the forecast. Indirectly, through presidential approval or preference polls, economics may have had a greater impact on the forecast and vote, but it was clearly not the overriding factor in the election. Narrowly considering economic conditions while ignoring other facets of public opinion reduces chances of accurately predicting and correctly interpreting the results of elections.

5 Presidential incumbents have a decided edge over their opponents.

It was not that long ago that conventional wisdom regarded two-term presidents as an endangered species. At least on the Democratic side, evidence seemed to support the one-term-and-out thesis. The last Democrat to win two consecutive presidential elections was Franklin Roosevelt. Though the conventional wisdom has now changed, it is unclear whether presidential incumbency puts a candidate at an advantage or a disadvantage. The record of the past 12 elections suggests that it is neither. Of the 8 incumbents seeking reelection, 5 won and 3 lost. Not much of a bellwether.

All the forecasting models, however, indicate that incumbency matters and that a presidential party seeking a second term has a decided edge over the opposing party. While several models predict the vote for the party holding the White House and therefore do not explicitly include incumbency as a variable, under neutral conditions (50 percent approval ratings, tied preference polls, and average economic growth) each predicts an in-party popular vote victory with the in-party candidate receiving 52–56 percent of the two-party vote. The models differ over whether the incumbency advantage is a personal or a party advantage and whether it extends beyond a second consec-

utive term for a party, but each finds at least a first-term reelection advantage. As Helmut Norpoth has observed, only three times since the Civil War has the in-party been denied a second term, and the incumbent president did not run for reelection in two of these three cases. In the third case the incumbent, Democrat Jimmy Carter, did seek reelection and lost—the only instance in this century of a one-term party hold on the White House.

A comparison of the average votes for incumbents and challengers also suggests an incumbency advantage. The mean vote for the eight incumbents seeking reelection since 1948 was 54.2 percent. Presidential candidates of the out-party, on the other hand, received a mean vote of only 47.4 percent. And while three of the eight incumbents lost, none was trounced. The poorest showing was Carter's in 1980, and he got better than 45 percent of the two-party vote. Five of the nine defeated nonincumbents since 1948 lost by a greater margin. Presidential challengers sometimes lose by landslides. Incumbents almost never do. The last exception was Herbert Hoover in the 1932 Depression-era election.

6 Party identification explains voting behavior, but does not explain or help predict presidential elections.

Party identification remains the central influence on individual voting decisions. Most American voters identify themselves as either Democrats or Republicans, and most partisans loyally vote for their party's presidential candidate. But as important as partisanship is in guiding individual choices, none of the forecasting models has been able to come up with an aggregate measure of partisanship that has predictive value. Recent presidential elections illustrate the point. Over most of the past 30 years, more Americans thought of themselves as Democrats than as Republicans, yet Republicans won five of the last seven presidential elections.

There are at least two reasons why partisanship does not help forecast presidential elections. First, the parties are sufficiently competitive and the presidential candidates so well known nationally that elections are determined not by the fairly evenly distributed standing decisions of partisan voters but by the reactions of both weak partisans and independents to the particular presidential candidates and issue disputes of the election year. Second, as much as voters are influenced by national and historical forces, their choice ultimately boils down to a matter of the here and now. Partisanship colors a whole range of political attitudes about the campaign, but once one knows these attitudes, knowing the partisanship behind them adds nothing in a predictive sense.

7 In the geography of presidential elections, states matter more than regions.

When it comes to analyzing electoral geography, as we must given the Electoral College, we commonly think in regional terms. Regions share social, cultural, and economic characteristics that have important political

Table 2. The Presidential Forecasting Models

MODEL	Campbell & Wink	Abramowitz	Lewis-Beck & Tien	Fair Revised since 1992	Wlezien & Erikson New model
1992 STATUS	Accurate	Accurate	Revised	Revised since 1992	New model
DEPENDENT VARIABLE	2-party vote for in-party	2-party vote for in-party	2-party vote for in-party	2-party vote for Democrats	2-party vote for in-party
PUBLIC OPINION					
Preference poll around Labor Day	.56 (10.60)	—	—	—	—
July presidential approval rating	—	.20 (3.57)	.12 (1.17)	—	.22 (2.87)
Party of peace and prosperity index	—	—	.18 (2.40)	—	—
THE ECONOMY					
Real economic growth in election year	2.08 (5.14)	1.17 (2.69)	1.70 (2.60)	.66 (8.04)	—
Absolute inflation rate for prior 15 quarters	—	—	—	-.83 (3.40)	—
Cumulative economic growth during term	—	—	—	.99 (4.47)	—
Cumulative leading economic indicators	—	—	—	—	28.37 (3.38)
INCUMBENCY					
Party of the incumbent (Dem=+1, GOP=-1)	—	—	—	-3.35 (1.26)	—
Party of incumbent during war years	—	—	—	4.69 (2.09)	—
Incumbent president seeking reelection	—	—	—	5.17 (4.58)	—
Party seeking third term or more	—	-4.85 (3.30)	—	-2.36 (2.23)	—
Constant	22.69	43.77	24.96	46.77	39.06
Number of elections	12	12	11	20	11
R ²	.95	.91	.89	.96	.87
Adjusted R ²	.94	.88	.84	.94	.83
Mean absolute error	1.01	1.42	1.63	1.14	1.70
Standard error	1.49	2.13	2.54	1.90	2.71
1996 Clinton vote forecast:	*	57.02	53.31	49.50	55.59
Forecast winner:	*	Clinton	Clinton	Dole	Clinton

* See table 3 for Campbell and Wink conditional forecasts.

Note: t-ratios are in parentheses. The first three equations have been estimated dividing minor party votes evenly between the two major parties. Undecided and minor party preferences are similarly divided in the presidential preference poll variable. The Party Peace and Prosperity Index is based on two Gallup election-year survey items asking which party would be more likely to keep the nation out of war and which would do the better job of keeping the country prosperous. The index is the sum of the two 0-100 scales and is oriented in terms of the in-party. The economic growth variable is the second quarter (non-annualized) GDP growth rate in the Campbell and Wink equation, the first half year's annualized GDP growth rate in the Abramowitz and Lewis-Beck and Tien equations (reestimated using the same economic series as the first equation), and the third-quarter GDP growth rate per capita in Fair's equation (except for the war years). Interaction terms in Fair's (1996) equation specifies economic growth and inflation to be irrelevant during the war years. The cumulative index of Leading Economic Indicators is a weighted average with each successive quarter weighed 1.11 times the previous quarter. The third-term penalty variable in the Abramowitz equation is coded one when a party is seeking more than a second consecutive term and zero otherwise. In the Fair equation the index is one for a party seeking a third consecutive term and increases by an increment of .25 with each additional term. Since the Fair equation is oriented in terms of the Democratic Party, the sign is reversed when the Republicans are the in-party. The personal incumbency variable is coded one if the incumbent is personally seeking reelection and zero otherwise (as an unelected incumbent Ford is coded as a nonincumbent). The sign of the economic growth rate, inflation, and the number of 3 percent plus growth quarters are positive when Democrats are the in-party and are reversed when Republicans are the in-party.

consequences. Certainly Republican inroads across Southern states in the 1994 midterm elections demonstrated the potency of regional politics. Yet forecasting models at the state level, while recognizing the importance of regions, indicate that differences among states are crucial. Among the most important predictors of a state's vote in the upcoming election are its votes in the past two elections. These tend to be pretty consistent. The two-party popular vote at the state level in 1992 was very highly correlated with the vote in 1988 and 1984.

Table 1 places the states in order based on the average of their 1988 and 1992 two-party Democratic presidential votes. States that supported the same party in both elections are grouped together at opposite ends of the list, with Arkansas added to the Democratic base because of President Clinton's home state advantage. The 21 states that voted for Bush in 1988 and swung to Clinton in 1992—the 1996 battleground states—are ordered along with their electoral votes. The list highlights several features of modern presidential politics. First, while Republicans do not have a lock on the Electoral College, they do have an advantage. Even with the two-party popular vote margins for Bush in 1988 and Clinton in 1992 being about equal (53.5 percent and 54 percent of the vote), Republicans won 18 states in both years for an Electoral College base vote of 168 votes while Democrats held 11 states and the District of Columbia for an Electoral College base vote of only 113. From a different perspective, however, if the 1996 election runs true to form, Republicans will need to win at least 30 states to get an Electoral College majority, while Democrats will need to carry 21 plus the District of Columbia.

Second, there is no single battleground region. The 21 swing states are spread all over the country: 4 in the Middle Atlantic, 4 in New England, 2 in the South, 3 border states, 4 in the West, 1 in the Southwest, and 3 big ones in the Midwest. As for individual states, Georgia, New Jersey, and Ohio are “must win” for Dole; Illinois, California, and Pennsylvania are “must win” for Clinton. Of the big electoral vote states, Michigan is a “must win” for both parties. But Maine, with its 4 votes, holds the balance in the Electoral College—dusting off the old maxim, “As Maine goes, so goes the nation.”

The Forecast Models

Table 2 compares five of the major national presidential vote forecasting models. Clearly, the models use a wide assortment of variables. But with only a single exception (Fair's model), all incorporate measures of public opinion, economic performance, and incumbency (implicitly included in the constant of the four models predicting the in-party vote). The models also vary in complexity, from parsimonious two-variable models (Campbell and Wink, Wlezien and Erikson) to a seven-variable model (Fair) and from simple indicators (widely reported preference polls and approval ratings) to complicated indices (a geometrically decaying cumulative index of the leading economic indicators). Most produce forecasts with the release of the

second-quarter growth rates at the beginning of August, though Campbell and Wink's model requires Gallup preference poll data a month later, and the timing of Fair's forecast is indefinite, for it depends on growth rate and inflation data for the third quarter that are unavailable until late in the campaign and therefore must themselves be forecast.

The trial-heat model developed by Campbell and Wink, though the latest to yield a forecast, is the most accurate and one of the simplest. It indicates that the poll results in early September offer important clues to the November vote, but should be heavily discounted, owing to the tendency of campaigns to narrow, and adjusted by economic circumstances. The 1992 version of the model missed the division of the two-party vote by only about half a percentage point, despite the Perot disruption.

Although no candidate on record, including Harry Truman, has come back to win from as far behind as Dole was in late July (a 15-point gap), it is still too early at this writing to produce a definite forecast from the Campbell and Wink model. Table 3, however, offers contingent forecasts based on the historical range of polls around Labor Day. With a preference poll standing of more than 45 percent of two-party preferences at Labor Day, Clinton would be the predicted two-party popular vote winner. With a 51 percent Labor Day standing, his popular vote plurality would be a virtual certainty, based on past errors of the model.

The Abramowitz model, also right on target in 1992, uses the July presidential approval rating, real GDP growth in the first half of the election year, and a "time for a change" penalty variable for any party seeking more than a second consecutive term. It suggests that a party seeking a second presidential term is virtually certain to win if the economy is not in recession. With first-half GDP growth near normal (1.54 percent, non-annualized), it predicts that Clinton would be reelected even with approval ratings below 30 percent. With his July approval rating at 57 percent, Clinton is forecast to win reelection handily, with 57 percent of the two-party vote.

The Lewis-Beck and Tien model is a revision of a model (Lewis-Beck and Rice) that incorrectly predicted a Bush victory in 1992. After dropping indicators of midterm partisan trends and internal party divisiveness and testing alternative measures of prospective economic conditions, Lewis-Beck and Tien added an index of perceptions of the parties' relative abilities to preserve peace and prosperity to the first-half real growth in the economy and July presidential approval ratings. With about average first-half economic growth, neutral views of the parties' ability to deliver peace and prosperity, and a Clinton approval standing of 57 percent, the model would have to err by more than 3 percentage points for Dole to squeeze out a popular vote majority.

Fair's thoroughly revamped 1996 model predicts the Democratic share of the two-party popular vote with seven variables estimated over the 20 elections from 1916 to 1992. The model has no public opinion indicator, and despite the widespread perception of it as an economic model of elections, it is as much about

Table 3. Early September Trial-Heat and Economic Growth Model: Conditional Forecasts of the 1996 Two-Party Vote for Clinton

Percentage favoring Clinton in early September trial-heat poll	Predicted Clinton share of the two-party vote	Probability that the prediction of the winning candidate is correct
40%	47.21	91%
42	48.33	81%
44	49.44	61%
46	50.56	61%
48	51.68	81%
50	52.80	91%
52	53.92	96%+
54	55.03	96%+
56	56.15	96%+
58	57.57	96%+
60	58.39	96%+

Note: Based on the model by James Campbell and Kenneth Wink reported in Table 2 and a reported second-quarter GDP growth rate of 1.04 percentage points (non-annualized). The trial-heat polls divide undecideds and those with third-candidate preferences evenly between the two major-party candidates. The probability that the vote forecast correctly identified the winning candidate is based on the distribution of the forecast model's out-of-sample errors for previous elections.

incumbency as about the economy. Although it accounts for the past 20 elections quite well, it is not an easy fit and skeptics might well wonder whether future forecasts will require further tailoring. As for 1996, anticipating per capita GDP growth of 2.1 percent, inflation at 3.0 percent, and 8 quarters of good economic news during Clinton's first term, Fair forecasts the president garnering 49.5 percent of the two-party vote, a virtual dead heat.

The forecast of the new Wlezien and Erikson model is based on a cumulative index of the leading economic indicators over the presidential term (discounting early values) up through the second quarter of the election year and the president's approval rating in July. Based on the index computed through the first quarter of 1996 and with Clinton's 57 percent approval rating, the model tentatively forecasts a Clinton victory between 55 percent and 56 percent of the vote.

With the exception of Fair's (and the indeterminacy at this writing of Campbell and Wink's), the models forecast a fairly easy reelection for President Clinton. Based on historical experience since the end of World War II, he seems very likely to ride his resurgence in presidential stature since the disastrous 1994 elections and a reasonably healthy economy to four more years in the White House. If Kenneth Starr's independent investigation of the Whitewater, White House Travel Office, and FBI files affairs produces the ultimate "October surprise"—the damning evidence of serious misbehavior by the Clintons long sought by their Republican critics—this prediction would be put in jeopardy. But this would also be a first in American politics, something that by their very nature forecasting models cannot anticipate. ■

The Alienated

Are The News Media To Blame?

by Richard Harwood

The attention of the American public is not riveted on government. As we are constantly reminded by polls and academic studies, millions of our people can't name their city council members, their representatives in state government, or their representatives in Congress. Ten times more people can identify Judge Ito or Judge Wapner of TV's people's court than can identify the Chief Justice of the United States. Half our people don't vote in presidential elections. Some 80–90 percent don't vote in many local elections. The Pew Research Center for People and the Press never lets us forget that people pay little attention to the latest happenings in Washington or in Bosnia and China. Most of us are pretty much oblivious to something called the "Contract with America" and other hot button issues of the day in Washington. One of the endearing anecdotes from my days as a political reporter in Kentucky involved a congressional candidate who was asked to state his position on the Taft-Hartley Bill. He did not equivocate: "By God, if we owe it we ought to pay it!"

The Man in the Back Row

Seventy years ago, in "The Phantom Public," Walter Lippmann gave us a sketch of the democratic condition. "The private citizen," he wrote, "has come to feel rather like a deaf spectator in the back row, who ought to keep his mind on the mystery off there, but cannot quite manage to stay awake. He knows he is somehow affected by what is going on. Rules and regulations continually, taxes annually, and wars occasionally remind him that he is being swept along by great drifts of circumstance.

"Yet these public affairs are in no convincing way his affairs. They are for the most part invisible. They are managed, if they are managed at all, in distant centers, from behind the scenes by unnamed powers. As

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a private person he does not know for certain what is going on, or who is doing it, or where he is being carried. No newspaper reports his environment so that he can grasp it; no school has taught him how to imagine it; his ideals, often, do not fit with it; listening to speeches, uttering opinions, and voting do not, he finds, enable him to govern it. He lives in a world in which he cannot see, does not understand, and is unable to direct.

"In the cold light of experience, he knows that his sovereignty is a fiction. He reigns in theory, but in fact he does not govern. Contemplating himself and his actual accomplishments in public affairs, contrasting the influence he exerts with the influence he is supposed according to democratic theory to exert, he must say of his sovereignty what Bismarck said of Napoleon II: 'At a distance it is something, but close to, it is nothing at all.'"

It is not, I think, entirely cynical, to conclude that these sentiments are as relevant now as then. We may be born equal in the sight of the divinity and we may possess certain inalienable rights. But equal status in the political system and in the economic order is not among them. According to the dictum in Washington, your Rolodex defines who you are. I would add that it is not only the names on your Rolodex that count but the names—especially your own—on the Rolodexes of the people we call. After unanswered phone calls following his retirement, a journalistic colleague said he had made a discovery: "I'm not a has-been. I'm a never-was."

In terms of political access, that is the normal plight of the average man and woman. They know, like Lippmann's man in the back row, that real political power is as unequally distributed as wealth and health in our democracy. The Friends of Bill are not on the same row with the Friends of Joe Six-Pack. This gets our attention in the press every few years, but it is unclear if we in the media bear responsibility for this state of affairs or, if we do, how we can repair the system.

In any case, the large promises implicit in the idea of "one man, one vote" have never been realized whatever the roles the press has assumed in political

American Voter

affairs over the history of our country. In an earlier age when the concepts of self-government and citizen legislators became our foundation stones, it was taken for granted that the tasks of governing should be assigned to a small element of society—men of property and

learning. We attached many qualifications for voting and other participation in public affairs—sex, race, literacy, age, residency, and property ownership. It was also taken for granted that newspapers on the whole would be controlled subsidiaries of the political parties.

Once upon a Time, a Passion for Politics.

Many of the requirements for voting and office holding eventually were discarded and a commercially successful press emerged, a press no longer financially dependent on the parties but still capable of partisan practices that today would shock journalistic critics and practitioners out of their socks. We entered a long era in which great numbers of the unwashed and less privileged not only gained the franchise but gained office. A passion for politics stirred the masses as Tocqueville and other travelers noted. Not everyone was pleased. In Boston, having the Irish in City Hall was comparable to having barbarians in the Temple. Others elsewhere had similar reactions as rewards for political activism became more and more visible and political participation became more common. There was job patronage on a large scale. There were also turkeys, coal, and bail money from the precinct captain; immunity from arrest for barkeeps, gamblers,

and prostitutes, as well as flexible judges if you wound up in court; construction contracts and franchises for loyalists and high bidders.

This was more democracy than the country had ever seen, and it was inspired not only by greed or hope of material gain but by the partisan fraternalism and sense of belonging that we now call communitarianism and by lasting emotional intensities arising out of shared experiences, most especially the Civil War. An obvious legacy was the Solid South's century-long commitment to the Democratic party and Republican voting patterns that have endured even longer. The poorest county in Appalachia for a long time was the most Republican county in Amer-

ica and still is so far as I know.

The rituals and celebrations of politics strengthened and sustained these bonds. Thousands gathered for grand feedings where the suds and whiskey flowed all night. Spectacular rallies at the precinct club house featured songs and banners, hours of speechmaking, exciting parades with bands and torchlights, dances and games of chance. Newspapers stoked these fires for a public in which education, as we define it today, was a scarce commodity.

When the first popular election for president was held in 1824, the turnout of eligible voters was about 27 percent. By the end of the century turnouts of 70–80 percent were common. They then fell off precipitously.

Most Americans pay very little attention to the latest events in Washington, D.C.

Progressive Reform

Speculation about the fall-off in popular political participation in this century abounds. One theory assigns blame to the ever-present reformers who concluded that too much raw democracy was ruining the country. In response there arose among the middle and upper classes a strong Progressive movement designed to destroy the city political machines and the patronage and corrupt practices on which they thrived. The movement involved such radical proposals as a merit system for public employment; the use of trained accountants and auditors to keep the books in order; anti-nepotism laws; universal suffrage coupled with foolproof voter registration systems and various other

safeguards against electoral fraud. These proposals coincided with the rise of social science as a legitimate field of scholarly endeavor and the rise of credentialism as a panacea for many ills. Doctors, lawyers, architects, teachers, and engineers, among others, would henceforth be credentialed by colleges and universities and licensed to pursue their professions or vocations. Eventually, licensing boards were set up for hairdressers, barbers, morticians, cabdrivers, the building trades, and so on. So why not credentialed public employees?

The thrust of it all was that the nation should have “clean” government and “clean” elections and should bring to government businesslike management of its financial affairs and to government and business alike



“professional” management and skills. Even newspapers began talking about the need for an educated newsroom labor force and for journalism schools to provide the training.

A generation of “muckrakers,” led by such figures as Lincoln Steffens, Ida Tarbell, and Ray Stannard Baker, exposed the inner workings of the corrupt political machines and the corrupt use of economic power by corporations such as Standard Oil and American Sugar. Their work inspired newspaper people all over the country to emulation.

The results of the Progressive movement were mixed. Many reforms were achieved with lasting beneficial effects on society—child labor and antitrust laws, for example. But they had some unintended consequences.

Exit the Voters

Cleaning up government and elections greatly diminished the rewards of political activism for those whose credentials were nonexistent. One had now to pass a test or have a diploma to get a job; political loyalty

was no longer enough. The Progressives and their muckraking allies had hoped that an “aroused public opinion would fulfill the promises of democracy,” clean up the mess, and move society toward a more utopian state. Instead, what followed was apathy and disillusionment. Voter turnout fell 40 percent from 1896 to 1920. Steffens’s marvelous book on the underside of politics, *The Shame of the Cities*, sold only 3,000 copies. Peter Finley Dunne’s character, Mr. Dooley, asked a salient question: “Is there an institution that isn’t corrupt to its very foundations? Don’t you believe it.”

The years since the mid-1960s are regarded by many journalists as the Second Muckraking era. All institutions have been fair game for investigative reporting and critical assessment. In part, because of these efforts, the political process in one sense has been “purified” as Progressive reforms have been realized. The spoils system is by and large a thing of the past. Barriers to voting have been eliminated. Political party bosses are extinct, the smoke-filled room an archaic memory. The party machines that once provided the foot soldiers of politics have been replaced by a professional class of political consultants who in 1992 were paid \$250 million to manage the elections of congressional candidates. That does not include the tens of millions of dollars paid consultants that year for presidential campaign services. They create the propaganda, raise the money, train and market the candidates, define issues and election strategies, organize rallies, get out the vote, and write the script for party conventions. They perform virtually all the functions once performed by ordinary people who now sit on the sidelines viewing elections, as Peter Shapiro has written, either with indifferent detachment or as “shameful exercises in mudslinging, obfuscation and demagoguery.” The primary elections and caucuses that were intended to open up the system have been no cure for political alienation and mistrust. The participation rate in the primaries of 1992 and 1996 was barely 20 percent of the population. The rich vote far more than the poor except in unusual settings such as the District of Columbia, where Mayor Marion Barry’s vision of government—jobs for loyalists and the needy—has drawn enormous support in low-income wards.

Are the Media Responsible?

There are two important questions here. The first is whether apathy and lack of participation constitute a “problem” for American democracy. The second is this: if it is a problem, are the media responsible in one degree or another?

On the first point, some would argue with Lippmann and others that nonvoting by uninterested and uninformed people is not a problem at all. It was their view that instead of grading democracy on the basis of popular participation, we should judge the system

Do apathy and lack of participation constitute a problem for American democracy?

by the well-being of its citizens—their health, education, safety, housing, and material standards of living. If those tests are met, this argument goes, the system works regardless of the numbers who participate in elections or other-

wise take part in the political life of the nation.

That is not a popular argument. Academicians, politicians, and journalists tend to view the indifference or nonengagement of the electorate as a crisis. They are looking

for causes, and one of the suspects is the press.

Professor Thomas Leonard, a student of the media's influence on the Progressive Movement, concluded that the work of the muck-rakers was a major factor in the decline of political activism in that era. "It was," he wrote, "the discrediting of some basic assumptions about how democracy worked that made muckraking both shocking . . . and a message to pull back from political life." He based this judgment on circumstantial evidence, not academic science or research into the psyches of voters by professional pollsters and psychologists. Those tools weren't available then. In fact, the scholar Michael Robinson tells us that as late as the 1960s "most political scientists clung to the theory of minimal consequences . . . which relegates television and all mass media to a

If they are a problem, are the media responsible for them in one degree or another?

position of relative impotence in shaping opinion and political behavior."

That theory is now suspect as evidence accumulates that the media—television in particular—exert political power. In his doctoral dissertation in 1972, Robinson concluded that news and public affairs programs of the television networks were, in a broad sense, consistently propagandistic and sometimes malign. They evoked images of American politics "which are inordinately sinister

and despairing," causing the viewer to "turn against the social and political institutions involved, or against himself, [for] feeling unable to deal with a political system like this."

More recent studies have reached similar conclusions: "negative" news stories and "negative" political ads create cynicism, drive people away from political participation, and often confuse them to such a degree that they refuse to vote or even read about politics and government.

Keeping Politics in Perspective

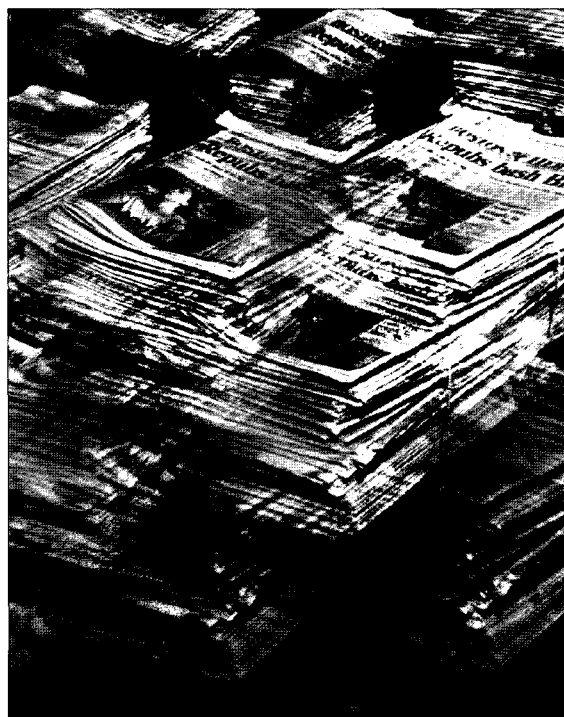
In pondering the implications of all this it is helpful to maintain a proper perspective. The fact that there are villains in government and politics and that the press is often wayward is not proof that political and governmental institutions are necessarily villainous or that journalists are always bad actors. That the American electorate includes many apathetic and politically ignorant people is not proof that the system is in terminal decline. A hundred million people went to the polls in 1992. The 80–90 million who didn't vote might very well have made a rational decision that they had little stake in the outcome.

A big ad in the *Wall Street Journal* last spring informed readers that "Without legislation correcting the BIF/SAIF premium disparity, SAIF's deposit base will almost certainly decline to the point that SAIF premiums would not cover FICO interest payments, resulting in a FICO default as early as 1997." What is the guy in the back row to make of that? It is well to remember that while politics is central in the lives of the political class and in the professional lives of journalists, that is not the case with all of us. As Austin Ranney wrote some years ago, "The fact is that for most Americans, politics is still far from being the most interesting and important thing in life. To them, politics is usually boring, repetitious, and above all, largely irrelevant to the things that really matter in their lives, such as making friends, finding spouses, getting jobs, raising children, and having a good time." So on election days, they may simply prefer to go fishing, secure in the knowledge, as Annie sings in her showstopper, the sun will come up tomorrow.

It is certainly true that many imperfections in our democracy remain despite the best and well-meaning efforts of reformers. It is also true that the media have,

in a large sense, much to answer for. Their own cynicism about politics and government has been infectious and often destructive. Their failure to put things in perspective is perhaps their greatest sin. But we have and will survive all that. As we deplore the state of democracy it clears the mind to ask: compared with what and with whom?

We can profitably remember and apply to the gloomy speculations and fears about the future Winston Churchill's great message to his country in 1940. "We are waiting for the long-promised invasion. So are the fishes." ■



THE DISAPPEARING POLITICAL CENTER

CONGRESS AND THE INCREDIBLE SHRINKING MIDDLE

SARAH A. BINDER

So far one of the big stories of the 1996 congressional elections is not who is running, but who is quitting. Thirteen Senators and 33 representatives have decided to step down voluntarily from their jobs. Most notably, these retirements are speeding along the thinning of the political center—the “incredible shrinking middle,” as one senator calls it.

Within the Republican party, the moderate wing occupies the political center—that is, it is closer ideologically to the midpoint between the two parties than to its own party’s ideological center. And retirements threaten to eliminate Republican moderates from Capitol Hill, with Senators Bill Cohen, Nancy Kassebaum, and Mark Hatfield deciding not to run again—following in the footsteps of fellow moderates John Danforth and David Durenberger, who reached the same conclusion before the 1994 election. Among Democrats the party’s conservative wing is closest to the political center. And it too is being depleted, with the likes of Senators Howell Heflin and Bennett Johnston and Representative Sonny Montgomery deciding to call it quits.

The result, many worry, is an unprecedented disappearance of the political center. In a political system that demands compromise and accommodation to bring about change, the center is considered vital to the moderate, bipartisan public policymaking generally preferred by the American public. Absent a political center, increased partisanship and ideological polarization are inevitable—and sure to feed public distrust of and distaste for politicians and the political process.

Whither the Center?

The political center in Congress has shrunk markedly over the past 15 years (figure 1). Hovering around 30 percent of House and Senate members in the 1960s and 1970s, the percentage of centrists in each chamber began slipping in the 1980s, and it has fallen to about 10 percent today. Centrists now can claim 11.3 percent of the House, down from 20 percent or more during the 1980s. And after peaking at 32.3 percent of the Senate during 1969–70, the first term of the Nixon administration, centrists make up less than 10 percent of today’s Senate.

The broadly similar declines in both chambers conceal several notable differences between the House and Senate and their two parties (table 1). In the House, both conservative Democrats and moderate Republicans have seen their ranks gradually thin since the early 1970s. But the conservative Democratic faction has consistently been larger than the moderate wing of the Republican conference since the late 1950s. Today conservative Democrats in the House still outnumber moderate Republicans three to one.

In the Senate, centrists of both parties actually increased sporadically from the mid-1960s to the mid-1970s before starting to decline during the late 1970s. But the most striking development in the Senate has been the depletion of conservative Democrats, whose numbers made up nearly a quarter of Senate Democrats during the late 1980s but in recent years claim only a handful.

Are Retirements to Blame?

The conventional wisdom is that voluntary retirements are newly driving the demise of the middle as House and Senate centrists find themselves too out of step with their parties to seek reelection.

As it turns out, the retirement of conservative Democrats in the House is nothing new. Conservative Democrats consistently made up the lion’s share of their party’s House retirements in every election save two between 1968 and 1978. But though conservative Democrats retired at very high rates during the 1970s, their contingent shrank only incrementally, suggesting that retiring conservative Democrats tended to be replaced by like-minded lawmakers. What is new is that Democratic conservatives who are once again showing an increased tendency to retire—particularly in the 1994 election and in the upcoming fall elections—are no longer being replaced by their own kind. Southern voters instead are electing conservative Republicans. The overall size of the Democrats’ right-leaning wing is steadily shrinking.

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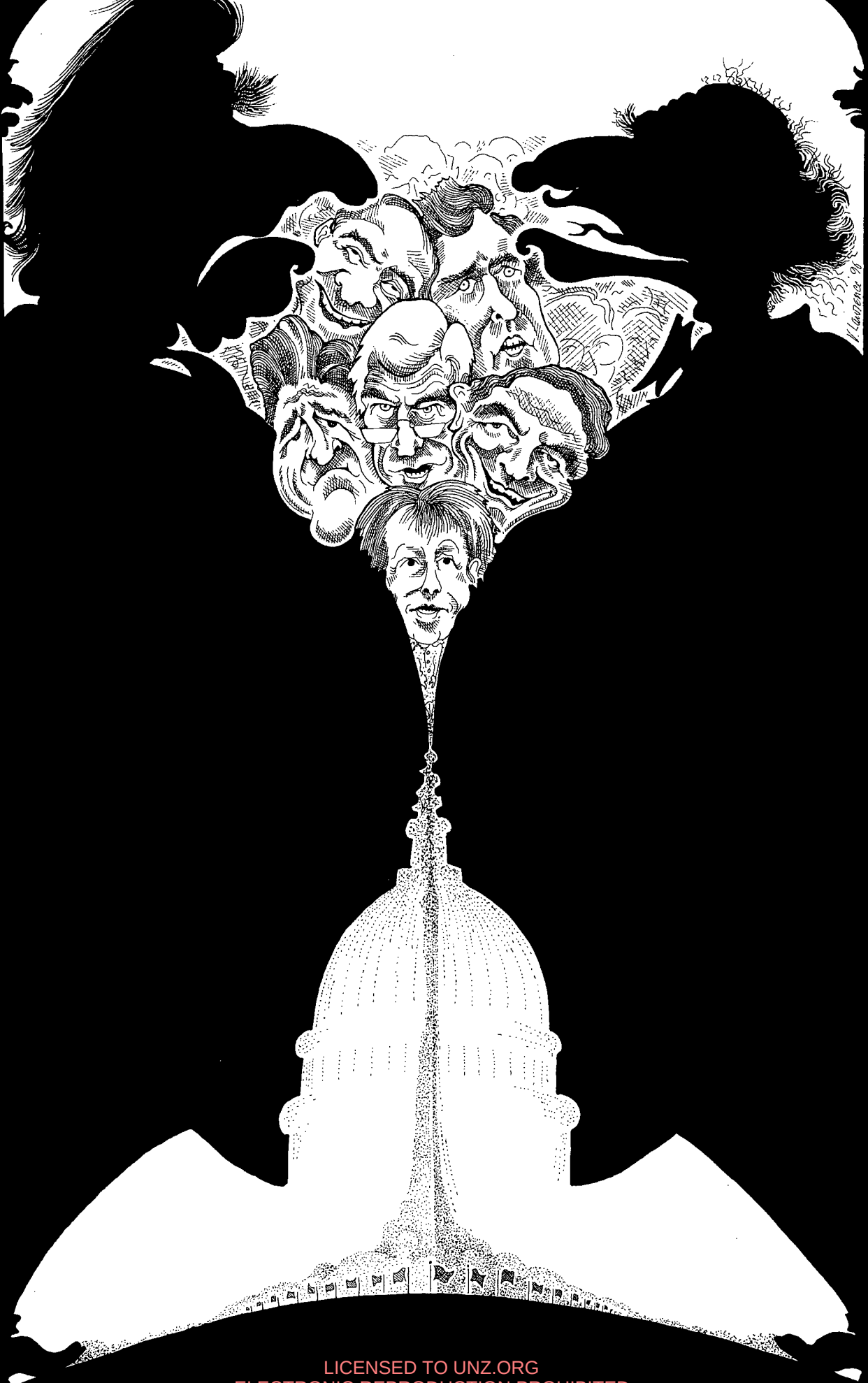
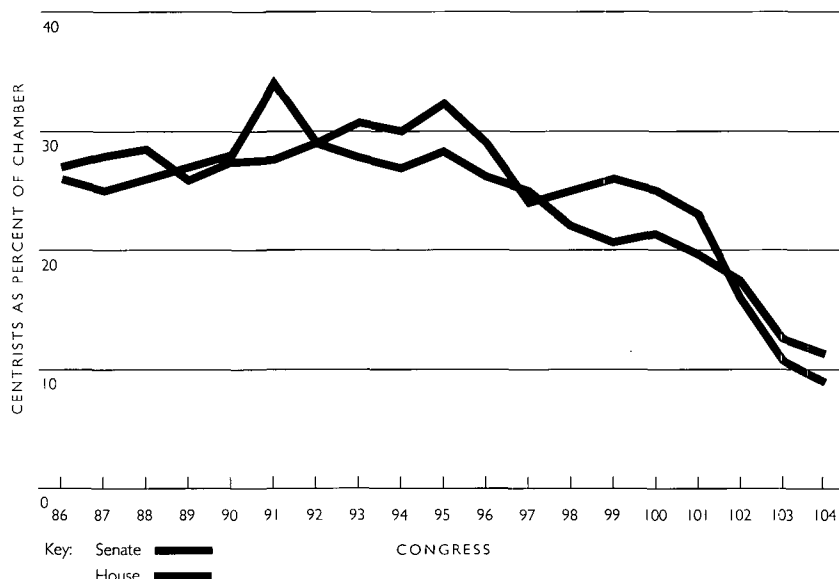
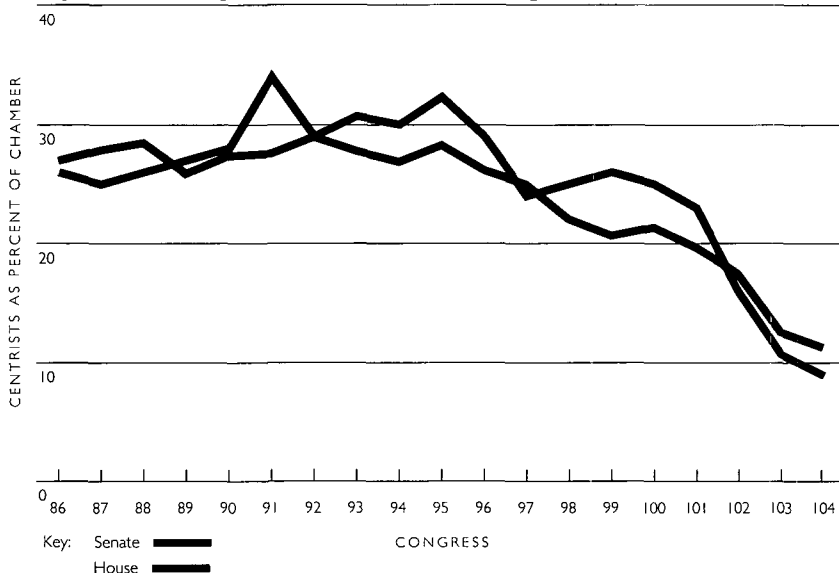


Figure 1. Size of the Political Center, 1959–96



Note: "Centrists" are defined as those members or senators whose ideological positions on a liberal-conservative dimension place them closer to the ideological mid-point between the two parties than to the median member of their own party. Ideological scores are drawn from first dimension coordinates of D-NOMINATE and W-NOMINATE scores calculated by Keith Poole and Howard Rosenthal from congressional roll call data. NOMINATE scores for the 104th Congress (1995–96) are based on the roll call votes through December 1995. See Keith T. Poole and Howard Rosenthal, "Patterns of Congressional Voting," *American Journal of Political Science*, February 1991.

Figure 2. Ideological Distance between Congressional Parties, 1959–96



Note: Ideological distance is the absolute difference between the median Democrat and median Republican in each chamber, based on Poole and Rosenthal's NOMINATE scores (see notes to figure 1).

Out of step with their more liberal colleagues, often unable to swallow the policy prescriptions of the new Republican majority, and facing voters who now prefer conservative Republicans to themselves, House Democratic conservatives (save those who jumped ship and switched to the Republican party) have little incentive to stay in the House. Observed retiring Pete Peterson (D-FL), "I have worked as a bridge-builder to find bipartisan solutions to our nation's problems. Unfortunately, the current political climate has rendered this approach ineffective."

Unlike their Democratic colleagues, moderate House Republicans have shown little distinctive inclination to retire, either now or in the past. Only in 1976 did moderates stand out in the roster of retiring Republicans. The steady decline of moderate Republicans since the early 1970s suggests that electoral defeat and replacement by more conservative Republicans, not retirement, has been at work. Although moderate Republicans make up less than 10 percent of the House Republican conference, they are not showing their discouragement by retiring. In fact, they have had some limited success in this year's congressional battles—helping to moderate the impulses of their conservative colleagues on issues ranging from protecting the environment to raising the minimum wage. The Republicans' slim majority in the House clearly enhances the leverage of their small moderate wing. In times past, recalled moderate Sherwood Boehlert (R-NY) early this year, Republican moderates got "more attention and consideration from the Democratic majority side than they did from the leadership of the Republican majority. That has changed."

In the Senate, most retirements among centrists are by Republicans, not Democrats. In fact the thinning of conservative Democratic ranks does not appear to have been driven by voluntary retirements. Although many conservative Democrats retired in 1968, 1974, and 1988, their numbers remained steady or actually increased slightly after each of those elections. The abrupt drop in the number of conservative Senate Democrats in recent years appears to be, again, more the result of the emergence of a conservative Republican electorate in the South than of voluntary retirements. To be sure, over time these two forces are likely to complement each other: as conservative Democrats are replaced by Republicans or in some cases by liberal Democrats, the more isolated their remaining political soulmates likely feel and the more likely they are to retire.

Among Senate Republicans, the retirement of moderates has only lately begun taking its toll on the dwindling center. Although the percentage of Republican moderates in the Senate has declined steadily since the 1970s, moderates did not dominate retirements until in the current electoral cycle—with 60 percent of retiring Republicans clearly from the left flank of their party. The gradual rightward shift of Senate Republicans in the past, it seems, has primarily been driven by election results, not voluntary retirements. This year is an important exception, as Republican moderates are calling it quits before testing the electoral waters. Seeing their numbers shrunk by elec-

toral forces in recent years and finding themselves increasingly isolated by their more conservative and homogeneous Republican colleagues, moderate Republicans are strongly inclined to give up their Senate seats. Democratic Senator John Breaux of Louisiana described their predicament best, noting recently that when a Senate moderate such as John Chafee “turns around and doesn’t see a Durenberger, a Danforth, he can’t be as effective.” Those in the middle, Breaux noted, “have to have someone to meet with. You can’t meet with yourself in a phone booth.”

A Congress without a Political Center

The shrinking political center has left Congress increasingly polarized (figure 2). Democrats are perched on the left, Republicans on the right, in both the House and the Senate as the ideological centers of the two parties have moved markedly apart. The change since the late 1980s is most extreme for the Senate, but striking for both chambers. From the late 1950s until well into the 1980s, the ideological distance between the center of the two parties remained relatively stable, even as the parties became more homogeneous. Since the 1980s the distance between the two parties has essentially doubled.

Some observers might see the parties’ movement toward ideological extremes as a benign, if not positive, development. Advocates of stronger political parties, for example, have bemoaned a political system that encourages the two major parties to drift toward the center. A disappearing center reflects to some extent the emergence of more cohesive and homogeneous legislative parties. And as the distance between the two parties grows, their philosophical differences on such matters as the appropriate role and reach of the federal government become more pronounced, giving voters a real choice between political agendas.

But the movement away from the center has been accompanied by a coarsening of politics and bitter partisanship—leaving voters increasingly disenchanted with Washington politics. Political discord has played itself out in part in an apparent decline in congressional comity. Senator Robert Byrd noted scathingly last year, “There have been giants in this Senate, and I have seen some of them. Little did I know when I came here that I would live to see pygmies.”

The polarized environment has also made it hard for members of both parties to meet in the center to forge compromise. As former majority leader Bob Dole lamented in retiring from the Senate, “None of us has a perfect solution. But there’s got to be some solution of where we can come together, Republicans and Democrats.” The further apart the two parties, the tougher it is to negotiate compromise, partly because fewer members are positioned in the center and partly because there is little incentive for others to reach into the middle. In the Senate, for example, Republicans this year adopted a new party rule that requires party leaders and committee chairs (who now must be confirmed by secret ballot) to pledge allegiance to a legislative agenda at the start of each Congress. Reaching across party lines is unlikely to be rewarded in such a partisan climate—something Senator John Chafee

Table 1. Size of the Political Center, by Chamber and Party, 1959–96

AS PERCENT OF PARTY

CONGRESS (YRS)	HOUSE		SENATE	
	CONSERVATIVE	MODERATE	CONSERVATIVE	MODERATE
	DEMOCRATS	REPUBLICANS	DEMOCRATS	REPUBLICANS
86 (1959–60)	32.0	17.7	23.1	31.4
87 (1961–62)	33.1	20.1	23.1	28.6
88 (1963–64)	33.0	22.0	25.4	27.3
89 (1965–66)	29.0	19.3	26.5	28.1
90 (1967–68)	34.0	18.7	31.3	22.2
91 (1969–70)	34.2	19.4	31.6	37.2
92 (1971–72)	32.6	23.9	31.5	27.3
93 (1973–74)	31.3	23.4	28.1	35.7
94 (1975–76)	29.2	22.2	28.3	34.2
95 (1977–78)	30.8	23.1	31.7	34.2
96 (1979–80)	29.0	21.4	29.3	29.3
97 (1981–82)	29.1	19.8	23.9	24.5
98 (1983–84)	25.8	16.8	26.1	24.1
99 (1985–86)	24.9	14.8	25.5	26.4
100 (1987–88)	25.2	15.8	23.6	26.7
101 (1989–90)	20.8	18.2	23.6	22.2
102 (1991–92)	20.5	12.6	9.1	24.4
103 (1993–94)	14.6	9.6	3.5	19.6
104 (1995–96)	18.0	5.5	2.1	14.8

Source: See notes for figure 1.

discovered after trying unsuccessfully to negotiate a bipartisan solution to the health care debate in 1994. In the House, several moderate Republicans were passed over for committee chairmanships when their party captured the majority in 1994. Carlos Moorhead, a conservative Republican from California with a reputation for conciliation, was in line to chair both the Commerce Committee and the Judiciary Committee and failed to get either—because, his chief aide contended, Speaker Newt Gingrich had let it be known that Moorhead was “just not mean enough.”

Increased polarization may have the most profound effects in the Senate. Unlike the House, where simple partisan majorities can prevail over minority opposition, bipartisan agreement is all but essential in the Senate. Unless the majority in the Senate has a filibuster-proof roster of 60 senators consistently willing to cut off debate, it will continually be stymied by minority opposition. Much of the legislation that grew out of the House Republican Contract with America in 1995 languished and died in the Senate despite the support of the majority—a fate that illustrates well the effects of ideologically distant parties in the Senate.

Of course, the ideological centers of the two parties are not fixed in stone. In fact, as the congressional elections approach, many voters seem apprehensive about the excesses of the Republican majority, and congressional Democrats seem determined to moderate their platform and image. It may be that voters will nudge the two parties back to the center—giving the political center a reprieve from its predicted demise. ■

T OO CLOSE TO CALL

A R O U N D T A B L E D I S C U S S I O N O F T H E 1 9 9 6 C O N G R E S S I O N A L E L E C T I O N S

On July 26, Thomas Mann, director of the Brookings Governmental Studies program, hosted a discussion of the upcoming fall congressional elections. Excerpts from the discussion follow.

TOM MANN: As we speak, Bill Clinton, with 57 percent approval ratings and a rather healthy economy, is likely to win reelection. But the congressional races seem wide open. What do you expect to happen in November?

STUART ROTHENBERG: Let's start with the House. National "generic" polls asking voters whether they prefer Democrats or Republicans in the House find a majority for the Democrats that ranges from 51 percent to as high as 63 percent. Realistically, the range is from 53 percent to 57 percent. At the bottom of that range, probably the Republicans would hold on to Congress; at the top, they wouldn't.

I think we all know the reasons for the national preference for the Democrats. It has much to do with House Speaker Newt Gingrich and the House Republicans. It has something to do with the individual candidates. Early on I thought the Republicans had an edge in candidate recruitment. I don't think so anymore. I see lots of terrific candidates on both sides. In addition, the Republicans are divided over issues like abortion and minimum wage. And they appear to have no coherent unified message, either at the top in the Dole campaign or coming out of Congress. All this has contributed to a huge advantage for the Democrats.

Looking at it race by race, right now I see a Democratic gain in the House of 8–12 seats. I give them

about one chance in three of taking over the House.

TOM MANN: What about the Senate?

RON ELVING: I expect continued Republican dominance. A margin of 53 to 47 would be a good showing for the Republicans. All the Democrats need to take control is 50, with Al Gore available to break tie votes. If the South is an even split, then the Democrats don't need all the "M" states—Montana, Minnesota, Michigan, Massachusetts. A big Clinton win could push close ones the Democrats' way.

ADAM CLYMER: What does it take for the Democrats to get to 50?

RON ELVING: All the incumbents would have to win. They'd have to take Maine and Oregon and sneak up on another.

TOM MANN: What about the race between Jesse Helms and Harvey Gantt in North Carolina?

RON ELVING: Helms is vulnerable. He's never won by big margins. His all-time peak was 52 percent.

TOM MANN: If Clinton has a big win—say, 10 points—would you expect a Democratic majority in the Senate?

RON ELVING: No. But if he gets more than 10, then it could happen.

TOM MANN: Stu, do you agree with Ron?

STUART ROTHENBERG: The Democrats could pick up a couple of seats. A majority in the Senate is doable for the Democrats, but unlikely.

TOM MANN: What matters from now until the election in November? Does it matter what eventually passes this Congress and becomes law?

ADAM CLYMER: Until recently, the Republicans seemed to think that they could win by blaming Clinton for vetoes. They have changed their minds and now they want bills enacted, not just confrontational issues. Getting welfare signed makes a big difference.

TOM MANN: Chris, what's your take on that? With welfare reform and the Kennedy-Kassebaum health care reform bill enacted and signed into law, would they have enough to block the criticism of an unproductive, querulous Congress and hold their majority?

CHRIS BLACK: Well, the other thing they have to do is defend what they did last year. What's killing some Republicans, especially up my way in New England, are the roughly 700 roll call votes in defense of the Republican agenda. And those don't go away. They're out there in black and white. I don't know whether the minimum wage and Kennedy-Kassebaum

P A R T I C I P A N T S

Christine Black, Congressional Reporter, *Boston Globe*

Adam Clymer, Assistant Washington Editor, *New York Times*

E.J. Dionne, Jr., Washington Post Writers Group and Senior Fellow,
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Ronald Elving, Political Editor, *Congressional Quarterly*

Stephen Hess, Senior Fellow, Brookings Governmental Studies Program

Cragg Hines, Washington Bureau Chief, *Houston Chronicle*

Thomas Mann, Director, Brookings Governmental Studies Program

Stuart Rothenberg, Editor, *The Rothenberg Political Report*

John Yang, House Correspondent, *Washington Post*

bills are going to be enough to offset the negatives.

TOM MANN: So the public got a fix on this Congress, probably during the government shutdown last winter and the immediate aftermath, and there's relatively little the Republicans can do in the remaining weeks of Congress to alter that?

JOHN YANG: Look at the polling. It really started to turn down for Gingrich personally and the Republican Congress as a whole during the shutdown. Then Gingrich complained about having to ride in the back of Air Force One. I think people's image of Congress was locked in from that point on. Nothing they've done since has changed it.

STUART ROTHENBERG: I agree completely that the shutdown was absurd and allowed the Republicans to be portrayed as inflexible and unfeeling. But the question is a little different now, in the context of the individual races. There the referendum is not on Congress but on the congressman, and incumbents always do well. An incumbent can always go back and make it a purely one-on-one race.

TOM MANN: No doubt the national context works against the Republicans. But will individual Republican incumbents and challengers be able to position themselves in their districts to blunt that effect? Most analysts believe that incumbency is worth 5–6 percentage points.

STEVE HESS: Yes, based on the incumbents' ability to raise money and on the services they perform for their constituents. But what about open seats this year?

TOM MANN: Here the Democrats have a slight disadvantage. There are roughly 10 more open Democratic seats than Republican seats, and they tend to be clustered in the South, in districts where Republicans have a good shot.

CRAGG HINES: But in the South Bill Clinton was poison in 1994. He's not necessarily poison there today. Look at Tennessee especially.

TOM MANN: That raises an important question. We thought we saw in the 1994 elections the cresting of a regional Republican realignment that had already worked its will in presidential and statewide voting. Is that not true? Is it possible that the Republicans will not only fail to extend their margins in the South in 1996, but fall back from the 1994 surge?

CRAGG HINES: I think we're at a marginal Republican South, not a solid South. If you look at state legislative races, there's rough parity. If you look at congressional seats, there's a slight Republican edge.

STUART ROTHENBERG: The way I would say it is that the playing field is level in the South, where it's not level nationally. But that's still a big difference from two years ago. I still think the Republicans are going to pick up seats in the South. But they're not going to do nearly as well as if these seats had been open last time.

STEVE HESS: Ultimately the future of Congress is going to rest on the South. This year for a variety of reasons, the Republicans may not do as well as we might have once predicted. What about two years hence? The momentum is for, what, a solid Republican South?

TOM MANN: Ten years from now in the House,



will the South be as Republican as it was Democratic 30 years ago?

CRAGG HINES: You could have a Republican majority in the South, but not an operational Gingrich majority. Something more toward the center.

E.J. DIONNE: We may see a new regime of congressional elections. At the beginning of each election both Democrats and Republicans will have a good shot of winning control of the House. We could be facing a time of flip-flopping control. The Democrats have lost what was once their ballast in the South. The Republicans may have some advantage there but not an overwhelming one, and the Democrats have some edge in the Northeast. The Senate has been competitive since 1980. Now the House will be too.

STUART ROTHENBERG: Is the increased competitiveness of House races a function of judicial redistricting?

TOM MANN: As best we can tell, it is not. It is a function of the ability of a party and a set of candidates to nationalize their campaign, to evoke a stronger connection between party and ideology.

STUART ROTHENBERG: But look at California. The redrawn district lines themselves made for more competitiveness in California.

ADAM CLYMER: They drew a Republican map.

TOM MANN: We have to wait to see the careful assessments of the impact of redistricting, but my sense is that it has less to do with the makeup of the constituency and more to do with the change in the stimulus—what voters are hearing and seeing, the kind of campaigns being waged, the flow of resources to districts that make some more competitive, the ability to get challengers in the right place with the right message.

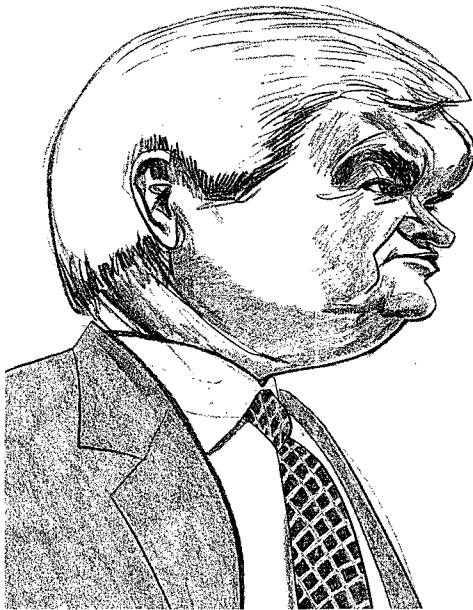
CRAGG HINES: But only in marginal districts.

TOM MANN: That's right. The action still remains in a relatively small proportion of the House districts.

E.J. DIONNE: The Democratic lock on the House from 1954 to 1994 was inherently artificial. You still had a holdover of Democratic congressional voting in Southern seats, often for very conservative Democrats who spent most of their time voting with the Republicans. The revolution we're seeing is not the one Newt Gingrich talks about, but an electoral revolution where that ballast for the Democrats is permanently gone. And absent that ballast the possibility exists for changing control from one election to another. And to the extent that's true, then the behavior of the Democrats if they took the House back would have to be very different than it was for the past 40 years.

TOM MANN: So do we have a regime of competitive control of the House or are we likely to fall back into one-party dominance, this time Republican?

ADAM CLYMER: I don't think the Republicans are going to be dominant for 40 years. But they have a fundamental edge that the Democrats can't take



away—the combination of money and the Supreme Court's extraterrestrial understanding of how politics is conducted. The Republicans can get more money and, thanks to the Supreme Court, can use it any way they like. It's not as good an anchor as the Democratic South, but it's likely to work for them because business has more money to throw around than unions, and by and large business is pro-Republican.

CRAGG HINES: I agree with Adam. Clinton has to have a huge lead to get to Democratic control of the House.

ADAM CLYMER: I think they could do it with a 12-point lead.

CHRIS BLACK: I think in the short term it's competitive because both parties are still having problems defining what they're all about for the next millennium. The Democrats are further along than the Republicans, and that helps them offset other Republican advantages. That's one reason I thought that Dole would be a disastrous candidate for the Republicans this year. I thought a candidate like Phil Gramm

would help them move along in terms of their internal debate about what they're going to represent. And despite all the talk about the Gingrich revolution, I don't think that's what the Republican party is going to be if it succeeds in the next 5–10 years. The Democrats, surprisingly, especially in the House, are much further along. There's a real sensibility of what being a Democrat is all about these days despite the party's incredibly messy spectrum. So I think it's competitive.

ADAM CLYMER: But the real test for that unity is when you're in the majority.

CHRIS BLACK: True, defeat concentrates the mind. The Democrats learned a lot from all the years they were out of power in terms of the presidency. Up my way in New England, where I have the most liberal people in the world, liberal Democrats are much more pragmatic than they were 5 or 10 years ago. Clinton's enormously popular in Massachusetts.

E.J. DIONNE: I once heard the story that when Clinton was way down in the polls, he took a trip to Massachusetts. Someone told him his popularity there was still at 60 percent, and Clinton turned to the person and said, "They really are out of touch up here, aren't they?"

JOHN YANG: Even if 1994 did not represent a shift in the way the country is going—and we won't know for a while—on a practical level, the Republicans are going to have an edge if they hold on to the House. You're going to see a lot more retirements, a lot more Democratic open seats. Democrats like John Dingell are not going to sit around and wait to try to get their committee chairmanships back. That's going to give the Republicans an edge.

TOM MANN: If the Republicans hold on this time, as they have a good chance of doing, and if Clinton wins reelection, 1998 will probably be a bad year for the Democrats, and the Republicans could move into a more dominant position then.

JOHN YANG: More dominant. It's going to take a long time to build up the margins the Democrats had, but the Republicans are going to have the edge to hold on to the House for a while. They'll get more entrenched with money, with all the powers of incumbency.

ADAM CLYMER: So this year is very important for the Democrats.

E.J. DIONNE: Is it possible that the argument in the country has changed because of the last Congress? The whole premise of Republican dominance was the broad popularity of an anti-government philosophy. Yet when the Republicans made a serious effort to put that philosophy into practice, they got clobbered. The country really pulled away from what they were doing.

ADAM CLYMER: I don't know that the Republicans ruined the anti-government stance for all time by taking on Medicare and the environment. It's possible for the Republicans to regroup. I just don't see anybody near the top of House leadership or in a position to get there who is that subtle. The alternative speaker to Gingrich is not Jim Leach, it's Dick Armey.

TOM MANN: Assuming that Clinton wins a second term, is it to his advantage to have a Democratic



or a Republican Congress?

CHRIS BLACK: Democratic. If Clinton is re-elected, he would be a much more effective second-term. There's a lot he's wanted to do—specific things he will do if he has a Democratic Congress, but not with a Republican Congress.

TOM MANN: Why would he have more success with this Democratic majority than he did with the 103rd Congress?

ADAM CLYMER: For a couple of reasons. First of all, the Democratic majority in the 103rd would in its heart of heart concede that it didn't play things all that well. Quite a few of the people who didn't play things all that well are gone—Tom Foley, for example, and Dan Rostenkowski. Now it may well have been to Clinton's advantage to have a Republican Congress these past two years—in terms of getting re-elected—but in his second term he will want to pass laws and do things and get in the history books, and the Republicans in either house of Congress are not going to give Clinton a thing.

TOM MANN: Some people say that Clinton would be better off with a nominal Republican majority.

RON ELVING: Take the model of the comeback congress after Harry Truman was elected in 1948. The Democrats came back after a two-year hiatus and took control of the House and Senate. What did the 81st Congress accomplish? Well, essentially the birth of McCarthyism. It was a terrible period in which the country's attempt to swing rightward after the New Deal was frustrated by the ineptitude of the Republicans in Congress. Truman and the Democratic Congress were not able to coalesce around an agenda or carry on the momentum of the New Deal. I think there's an argument to be made that if Bill Clinton is reelected in 1996, he would be better off with, perhaps, not a wildly Republican Congress that can override his veto but the kind of Republican Congress that we would be likely to have, that is to say a majority of 220 or 225 in the House, where the people who want to be reasonable and want to pass bills rather than have vetoes would be empowered theoretically. This, of

course won't accomplish health care reform or for that matter anything that Clinton ran on in 1992—except a balanced budget, which he could probably get to fairly quickly. But it could minimize the snap back in 1998. There's just a tremendous historical precedent for second-term disaster for the president's party. That's probably going to happen anyway, but if it happens in response to two years of Democratic control in the House and Senate and a second Clinton term, it could be truly precipitous. More positively, Clinton could accomplish some things on the middle-of-the-road side of his agenda. Yes, you can't energize the Democratic base by talking about these things, whether it's school uniforms or more police on the streets, but you could get a list of accomplishments possibly including some restraint on entitlements, even some kind of Medicare reform, through a blame- and credit-sharing arrangement between a moderate-sided Clinton and a scared, but still Republican, Congress that decides it's better to deal with the devil than try to beat him when you don't have the votes.

TOM MANN: Look at the nature of the agenda and the issues Clinton's going to be dealing with. Almost everything important that comes up entails not distributing benefits but imposing losses, and one party can't do that on its own.

ADAM CLYMER: But I think you get bipartisanship in the Senate more easily with a Democratic leader calling up the bills and setting an agenda and finding five Republicans to work with than you get with Trent Lott and Don Nickles.

TOM MANN: I don't think you reform social insurance with five Republicans.

STEVE HESS: I come down on Adam's side. Look at it from Clinton's point of view. He's reelected, and what's different? For the first time in his life since he was 28 years old, he's not running for elective office. Now he's running for his place in history. And now he wants to get something done. You don't go into the





history books for gridlock. So you start with the proposition that you really are better off having more of your own people, particularly when it's the difference between being the majority and the minority.

E.J. DIONNE: Particularly when they owe it to you. And, unlike 1992, Clinton will be in that position after this election.

CRAGG HINES: How does Clinton get into the history books? Not the way most Democrats want their president to get there. Do the Democrats want to be put into the position of being the party that provides the votes to reform Medicare, Social Security, and get their president into the history books? Dick Gephardt wants to go to Iowa and New Hampshire in 2000 and say I'm the guy who helped Bill Clinton reform Medicare and Social Security in a way these primary voters aren't going to like? Getting us on the verge of a balanced budget? I'm not sure Gephardt would go for that.

E.J. DIONNE: Stuart made a good point earlier. The lost opportunity for Clinton and the Democrats in the first term was to change popular attitudes toward government and to show voters that government can actually work. If there is any agenda for a second Clinton term, it is to change that attitude toward government based on something real. The next four years are about more than cutting entitlements. Two things could happen at the same time if the Democrats pull this off right. First, they can make reductions in Medicare without creating the kind of overwhelming opposition the Republicans created. Because the Republicans were not only trying to rein in the costs of Medicare, they were trying to fundamentally change it. You don't need to fundamentally change it to get some reductions. Then the question is does Clinton come up and say that the issue before the country is education, job training, and a whole package of things to make Americans more competitive in the next century? Does he say that the tax system is biased against

people whose income is dropping and is there a way of jiggling it so at least the government doesn't get in the way of the advancement of the people in the middle and the bottom? I think that's what Clinton will try to do in the next four years.

On the question of whether he's better off with a Republican or Democratic Congress, it's possible to be Clintonian about it and stand firmly on both sides. On the one hand it's not clear, especially in the House, that the Democrats can run a well-ordered house. If they can't, Clinton would be better off to have a very narrow deficit in the House so that Gingrich has to run things with a 5-seat majority, and the Democrats can start pulling off moderates like Marge Roukema and Connie Morella. On the other hand, especially in the Senate, if Clinton wants to get something done, the Republican leadership could still stand in his way. So one question the Democrats have to answer is can they run this place?

CRAGG HINES: So much depends on what happens when Bill Clinton is freed of the electoral albatross that has hung around his neck since he was defeated in 1980. If he's willing to put together the package E.J. is talking about, fine, but I still think it's the entitlements that get him into the history books.

TOM MANN: Saving social insurance, it's called.

CHRIS BLACK: It's Nixon going to China. It's the Democrats—and a Democrat like Clinton, especially in a second term and liberated from the political concerns he's always had—who will be able to make that case, to redefine the compact between generations, to redefine what government does and doesn't do. If they can pull that off, they are in a very different position nationally.

E.J. DIONNE: Only friends of these programs can reform them. Voters will accept constraints if they think the people doing the constraining are trying to save the program. If they don't believe the people are trying to save the program, they'll vote against them, as the Republicans learned. ■



The Gulf War Party's Over

BY SHIBLEY TELHAMI

One year ago the Middle East was defying its reputation. One of the most troubled spots of this century was well on its way to reconciliation. For the Clinton administration, the region was poised to provide a badly needed case of success in foreign policy as it headed down the stretch toward the fall election. The historic Palestinian-Israeli agreements, signed at the White House, and the subsequent Jordanian-Israeli peace treaty appeared unstoppable. Normalization between Israel and the Arab states was increasing by the week, and opponents of peace in the region were on the defensive. In the Persian Gulf, the United States successfully exploited regional fears of Iraq and Iran—and the impression that Arab-Israeli peace was around the corner—to bolster the presence of U.S. forces in the region with minimal opposition and to isolate Iran and Iraq. New and serious opportunities to unseat the government in Baghdad emerged last summer with the high-level defection of a confidant, and the son-in-law, of Iraq's president. In short, things looked good for Clinton.

Today the outlook is less promising. The extended Persian Gulf war victory party that the United States has enjoyed since 1991 is finally over. The election in Israel of Prime Minister Benjamin Netanyahu, who has expressed opposition to the principle of trading occupied territory for peace, seriously wounded U.S. diplomacy in the region. Even tactically, it has become hard to sing the virtues of Netanyahu to Arab partners, given that the administration had spent months emphasizing the danger of his election in its effort to help his political opponent, Shimon Peres. And Netanyahu has done little to alleviate fears about his intentions to build Jewish settlements in the West

Bank—something the United States sees as an obstacle to peace. Meanwhile Washington has lost initiative, reverting to reactive diplomacy.

Equally troubling for U.S. policy are developments in the Persian Gulf. Despite Washington's efforts, Saddam Hussein remains entrenched in Iraq; even the promising defectors were lured back to an ugly death in Baghdad. And while Washington successfully focused on external threats of invasion, new internal threats to Gulf security emerged about which the impressive U.S. presence in the region can do little. The two tragic attacks on U.S. forces in Saudi Arabia in the past year, and continued upheavals in Bahrain, where U.S. naval forces are headquartered, have been both painful and sobering—and have made Arab governments uneasy about the U.S. presence. Suddenly, American officials discovered that public opinion and domestic politics in the region matter after all—only to discover again how little they know about the extent of internal opposition within the region, especially Saudi Arabia, where fast-growing populations and declining oil revenues have halved average income in the past decade.

At the same time, U.S. efforts to isolate Iran and Iraq through the policy of "dual containment," which rules out any positive engagement with the two states, have run into obstacles. Attempts over the past three years to increase sanctions on Iran have not dissuaded Iran from seeking weapons of mass destruction and sponsoring terrorism. Indeed, the difficult economic conditions in Iran seem to have reduced its conventional military budget but increased its will to pursue non-conventional methods that are much cheaper. Meanwhile Clinton's signature on Senator Alfonse D'Amato's (R-NY) bill,

which punishes foreign companies investing more than \$40 million in Iran's (and Libya's) oil and gas resources, has strained relations with European allies and undermined U.S. leverage with Europe on issues like Bosnia and the future of the United Nations. And NATO member Turkey, now led by an Islamist prime minister, has signed a \$23 billion gas deal with Iran that, while not in apparent violation of the new U.S. law, helps Iran both economically and politically.

Even the isolation of Iraq is no longer assured. Some Arab states openly called for inviting Iraqi leaders to the emergency Arab summit in Cairo following the Israeli election, and humanitarian concerns for the plight of the Iraqi people are inclining even Iraq's enemies within the Arab world to call for removing the economic sanctions from that state. The changed political environment in Turkey is raising questions about U.S. ability to maintain for long the forces necessary to carry out Operation Provide Comfort in Northern Iraq.

The net result of these trends is a significantly changed regional and global context for U.S. foreign policy. "Staying the course" in the new environment is thus not a virtue. To be sure, all is not lost in the Middle East, since U.S. options, though narrowing quickly, remain wide. Washington still has significant capacities in the Persian Gulf. Arabs and Israelis have no choice but to compromise as the peace process, partly thanks to administration efforts, has gone too far to be reversed, and as the status quo in the Palestinian territories remains unviable for either Israel or the Palestinians. But it is now clear that a new U.S. approach will be needed in the Middle East immediately after the November elections. It won't be a day too soon. ■



Shibley Telhami, director of Cornell University's Near Eastern Studies Program, was a visiting fellow last year in the Brookings Foreign Policy Studies program.

Low Inflation or No Inflation?

BY GEORGE A. AKERLOF, WILLIAM T. DICKENS, AND GEORGE L. PERRY



From top: George A. Akerlof, William T. Dickens, and George L. Perry are senior fellows in the Brookings Economic Studies program.

With inflation stabilized at a 30-year low of less than 3 percent, the nation in its fifth year of economic expansion, and unemployment less than 5.5 percent, Federal Reserve Chairman Alan Greenspan has the economy pretty well in hand.

Some policymakers, though, think that things can get even better. Senator Connie Mack (R-FL) has introduced legislation that would change the Fed's mission from promoting three goals—maximum employment, stable prices, and moderate long-term interest rates—to promoting only price stability. Nearly every member of the Senate GOP leadership, including Bob Dole before he resigned, signed onto the bill, which was introduced in the House by Jim Saxton (R-NJ).

Many economists also endorse the goal of complete price stability. Because investment earnings are taxed without being adjusted for inflation, they see price stability as a way to avoid distortions to saving and investment that arise from even modest inflation. Because the standard analysis treats the cost of going to zero inflation (measured by the higher unemployment needed to get there) as temporary, these economists reckon such costs are justified by the permanent benefits of reducing tax distortions.

In recent work, however, we show that the costs of operating the economy with zero or near-zero measured inflation are likely to be large and permanent—as high as 3 percent of GDP a year indefinitely, with corresponding higher permanent unemployment.

The reason costs are so high stems from the reluctance of employers to cut wages. Both in good times and bad, some firms and industries do better than others. Wages need to adjust to accommodate the differences. In times of moderate inflation and productivity growth, unlucky

firms can easily adjust down their relative wages by freezing wages or at least giving smaller than average increases—without having to make absolute cuts. But when productivity growth is low, as it has been since the early 1970s, and inflation is zero, many firms can adjust their relative wages only by actually cutting wages. Because they are reluctant to do so, for fear of morale and retention problems, they keep their wages too high and employment too low.

A range of data on wage increases in manufacturing, union contracts, and employer surveys confirms the prevalence of this “downward wage rigidity.” While wage changes vary considerably from firm to firm, very few employees get wage cuts even when inflation is low.

A few studies that purport to show that downward rigidity is not an important feature of the labor market all make the same key mistake. Instead of looking directly at data on wage changes, they compute them from wages reported by workers in surveys taken a year apart. But such surveys are rife with error. People often can't remember their wages or don't bother to report them accurately. A recent study by John Shea of the University of Maryland found that while surveys of union workers implied that 21 percent had wage cuts, only 1.3 percent actually had cuts in their union contracts. We found similar overstatements when we analyzed direct evidence on survey response errors.

To see what all this means for a zero inflation target, we developed a model that simulates the economy, with thousands of firms, each subject to random demand and supply shocks that affect its desired employment and wages. When we ran the model with inflation lowered from 3 percent to zero, unemployment rose, under a wide variety of assumptions about

various aspects of the economy, between 1 and 3 percentage points. Only a few extreme sets of assumptions yielded effects below this range.

We looked for direct evidence that the economy behaves like the simulation by fitting a simplified version of our model to historical data and using it to predict actual inflation rates. In explaining the postwar years, we expected, and found, little difference between the accuracy of our model and a standard model that ignores downward wage rigidity, since postwar inflation was never low enough for downward rigidity to play a major role. But when we used the models to backcast the Great Depression, a period when high unemployment persisted through alternating periods of deflation and inflation, our model clearly dominated. The standard model went wildly off track, predicting accelerating deflation throughout the period. Our model correctly predicted the upswing in inflation (then deflation again and once more inflation) in the mid- to late 1930s, when the effects of downward wage rigidity became plainly evident.

Finally, we asked our historically estimated model what would happen if the Federal Reserve tried to stabilize inflation at, alternatively, 3 percent or zero. With a target of 3 percent, unemployment settles down in the range of the past year or so, around 5.5–6 percent. But at zero, it settles permanently at a level more than 2 percentage points higher. No plausible estimate of the benefits of zero inflation would warrant accepting such a cost in unemployment.

A low steady rate of inflation is surely a reasonable target for the Fed. Precisely what low inflation rate best serves the people of the United States, we cannot say. But we are confident it is not as low as zero. ■

America's Other ValuJets

BY DONALD F. KETTL

The tragic crash of ValuJet Flight 592 in the Florida Everglades last summer underlined a serious problem in the Federal Aviation Administration's regulation of the airline industry—though perhaps not the problem that congressional and public critics had in mind when they lambasted the agency in public hearings. And the problem ripples ominously throughout the federal regulatory structure.

Like all regulatory agencies, the FAA has been under increasing pressure to minimize its intrusiveness into the industry it is charged to oversee. The only good regulation, critics appear to think, is a dead regulation. But at the same time, vast changes are taking place in the way the airline industry operates, and those changes require increased regulatory capacity.

ValuJet, for example, expanded at a dizzying rate. Over the past year, its fleet doubled, and it relied on a helter-skelter network of dozens of contractors to keep up with maintenance. It now appears likely that miscommunication between the airline and one of its contractors led to dangerous oxygen generators being loaded into the belly of the ill-fated flight.

FAA administrator David R. Hinson forthrightly admitted that the agency had responded too slowly to signs of trouble at ValuJet. These signs, however, were anything but clear. ValuJet relied more heavily on a larger and less integrated network of support contractors than any airline had ever done before. It took the FAA a long time—not until after the crash—to determine how to apply its safety standards to such extended airline-contractor relationships. It struggled to do so at a time when most reformers wanted to trim its operations back substantially, and when ValuJet was the darling of Wall

Street for its rapid growth and low fares. That is scarcely an environment designed to support aggressive federal action.

The dilemma—regulatory puzzles quickly evolving beyond standard regulators' approaches, at the very time when many reformers want to trim, not enhance government regulation—extends to many other industries that threaten to create their own ValuJets. Critics of the Food and Drug Administration, for example, have complained that the agency's safety review of new drugs is far too slow. "Those of us who are sick don't have time for this," says one radio advertisement. The solution? Pare back the FDA's oversight and leave the safety reviews more in the hands of drug companies and private labs.

The states, meanwhile, are responsible for regulating the safety of toxic chemicals without having access to essential information. Under the Toxic Substances Control Act, manufacturers and processors must report information about their toxic chemicals to the Environmental Protection Agency. But under "confidential business information" protections contained in the act, EPA usually is not allowed to share the information with the states who regulate the industries. Some states that have been given access to the data have discovered huge problems, including companies that failed to obtain required permits or otherwise ducked state safety rules.

In these and scores of other programs, from the cleanup of nuclear waste sites to operation of the Superfund program, the real work is being done by networks of contractors outside the immediate reach of the government regulators charged with ensuring the public's health and safety. Government regulatory agencies have fewer resources and even less political

support for trying to get ahead of the curve. And if problems occur, from a plane crash to a drug that causes dangerous side effects, government agencies reap the immediate headlines and lasting blame—for failing to do well what many people did not want them to do at all.

The FAA has been criticized for being a "tombstone agency"—for responding only after a plane goes down. Some of the fault for reflexive regulation can surely be laid at the agency's doorstep, especially for failing to adapt quickly enough to an industry that changed far more quickly than it did. But a far larger share of the blame must be given to those demanding a miracle from government regulators: perfect safety at no cost.

Other ValuJets lurk quietly outside the public limelight and beyond the drumbeat for deregulation. The answer surely is not more heavy-handed command-and-control regulation that frequently defies common sense. Government regulators must develop fresh approaches to the tough regulatory problems they face, and they must learn how to apply those approaches in much smarter ways. Meanwhile, government regulators must be supported by the political will to do what has to be done. ■



Donald F. Kettl, a nonresident senior fellow at the Brookings Center for Public Management, is director of the Robert M. La Follette Institute of Public Affairs at the University of Wisconsin-Madison. He is the author, with Patricia W. Ingraham, Ronald P. Sanders, and Constance Horner, of Civil Service Reform: Building a Government That Works (Brookings, 1996).

else but reproduce the social order. When James Coleman and his colleagues purported to find that private schools were more educationally effective than public schools, they not only failed to make a convincing empirical case for private school superiority, but even more damaging was their nearly complete lack of sociological sophistication about the place of private schools in the class structure. In fact, in Coleman's work there is no operational or clearly articulated theory about the relationship between school and society. The same errors can be found in the work of Chubb and Moe and Bryk, Lee, and Holland. To propose a public school system for the next century on the questionable assumption that elite private schools and religious schools are educationally superior to public school is a "back-to-the-future" policy perspective that will ultimately fail.

But the problem goes deeper than data wars or weak analyses. Like other voucher advocates, Viteritti claims that those who argue for a clear separation of church and state have misread the intentions of those who wrote the Constitution. Historical mind reading is a dubious game, but I think it is safe to say that the authors of the Constitution believed that a civil society was most likely to occur when revealed beliefs about the supernatural world did not frame public discourse; private visions of heavenly paradise should not be imposed on those who merely seek earthly justice and freedom. Reason and skepticism were the watchwords of the Constitution's authors. I doubt seriously they would have been sanguine about spending public funds to support schools operated by religious orders for the perpetuation of the order's faith.

Civil society cannot be created by abandoning the concept of genuine equal opportunity, separation of church and state, and the just society. We need strong theories about human behavior, learning, and the relationship between school and

society if we are to redesign a public school system that produces graduates with open inquiring minds, moral courage, and self-confidence and who are not prone to rigid ideologies or fantastic escapist beliefs. We cannot create a new American Enlightenment with schools that are organized on the management theories of McDonald's or the world views of religions based on revelation. We need public schools that are accountable to the community, that uphold high academic standards, and that prepare students to be citizens capable of democratic reflection and action.

*Peter W. Cookson,
Teachers College, Columbia
University*

The Pentagon: Not One Penny for Corporate Mergers

■ Lawrence J. Korb ("Merger Mania: Should the Pentagon Pay for Defense Restructuring?" summer issue) asserts the Defense Department has fueled corporate consolidations and undermined competition in the defense industry by subsidizing several megamergers. Korb is wrong—there are no subsidies. The Department of Defense does not contribute one penny to the price one company pays when it acquires another.

The Department of Defense closely reviews mergers and acquisitions in the defense industry to ensure, first, that these transactions do not adversely affect competition for our programs, and second, that they do lead to lower costs. We communicate our views to the Federal Trade Commission or the Department of Justice for their antitrust reviews.

If these transactions are approved, we then permit contractors to include normal business costs in the prices they charge for defense goods. This includes employee and equipment relocation, job retraining, severance pay, early retirement incentives, and other costs associated with restructuring a business. With a few exceptions, these costs have always been allowed on federal contracts and have been paid without regard to whether they result in one company's inter-

nal downsizing or a business combination. Contrary to Korb's assertion, these are not the sort of organization costs that are unallowable under federal regulations.

As a result of legislation enacted two years ago, protections were implemented to ensure restructuring costs associated with business combinations are allowed only when there will be net savings for the Defense Department. Pentagon auditors must verify costs and savings, and the Under Secretary of Defense for Acquisition and Technology must certify that projected savings will exceed costs. For the four business combinations subjected to the net savings requirement so far, estimated restructuring savings exceed the costs by more than \$1 billion. To date, for two of the business combinations, actual savings for the Defense Department have already exceeded our costs. Those savings are being realized through lower prices on fixed price contracts that the Pentagon has awarded to the restructured firms.

It would make no sense for the Department of Defense not to allow contractors to include legitimate business expenses incurred to make them more cost-efficient producers in the prices they charge for defense goods. Ironically, some would seem to prefer for the Defense Department to finance inefficiency by paying prices that reflect the costs of keeping plants operating when they are no longer needed or cost effective. That is the kind of subsidy fully deserving the criticism it would undoubtedly receive!

*Paul G. Kaminski,
Under Secretary, Acquisition
and Technology, Department of
Defense*

Defense Restructuring: We All Win

■ It is difficult, in a letter, to cover all the inaccuracies in Larry Korb's article ("Merger Mania: Should the Pentagon Pay for Defense Restructuring?" summer issue). But your readers deserve to know some key facts about the important public policy issues Korb touches upon.

Fact #1: Defense company

mergers and acquisitions (which are part of the industry consolidation almost all experts agree is necessary in the post-Cold War world) are paid for entirely with corporate assets—absolutely no government funds or subsidies are used.

Fact #2: Federal regulations provide for reimbursement to contractors for reasonable restructuring costs—only if they yield overall cost savings to the government or preserve a critical industry.

Fact #3: Contractors pay all restructuring costs up front, and the government reimburses them from the savings generated—and in proportion to savings the government receives—over several years, through future contracts (which is effectively an interest-free loan for the government's share of restructuring).

Fact #4: The government requires and implements extensive auditing, reporting, and certification to assure company compliance, cost data, and overall savings.

Fact #5: Lockheed Martin restructuring actions from mergers and acquisitions since 1993 are estimated to cost a total of \$2.3 billion, prorated across all customers. The payoff: estimated savings to those customers—and U.S. taxpayers—of more than \$6 billion from 1995 through 1999 and \$2.6 billion every year thereafter, plus enhancing Lockheed Martin's global competitiveness and job opportunities for Americans.

Korb glibly calls this "merger mania," "taxpayer subsidization," and "windfall." At Lockheed Martin, we call it "win-win-win-win" for customers, taxpayers, employees, and a critical national industry.

*Susan M. Pearce,
Lockheed Martin Corporation*

Correction: The last sentence of the next-to-last paragraph of Kenneth Flamm's article in the summer issue, "World Watch: Semiconductors and Managed Trade," should have read: "Small steps through difficult terrain in semiconductors could ultimately blaze new paths for the entire GATT framework."

The Review welcomes comments from readers. Letters will be edited to conform to style and space.

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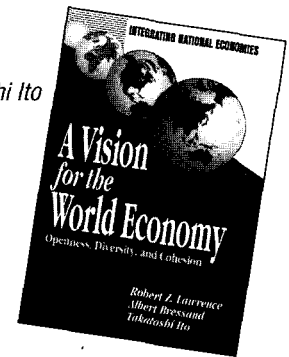
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